

**FEDERAL RESERVE DISTRICTS: GOVERNANCE,
MONETARY POLICY, AND ECONOMIC
PERFORMANCE**

HEARING
BEFORE THE
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POLICY AND TRADE
OF THE
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FEDERAL RESERVE DISTRICTS: GOVERNANCE, MONETARY POLICY, AND ECONOMIC PERFORMANCE

Wednesday, September 7, 2016

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONETARY
POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Members present: Representatives Huizenga, Mulvaney, Lucas, Pearce, Stutzman, Pittenger, Messer, Schweikert, Guinta, Love, Emmer; Moore, Foster, Perlmutter, Himes, Sewell, Murphy, Kildee, and Heck.

Ex officio present: Representatives Hensarling and Waters.

Chairman HUIZENGA. The Subcommittee on Monetary Policy and Trade will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Federal Reserve Districts: Governance, Monetary Policy, and Economic Performance."

I will now recognize myself for 5 minutes to give an opening statement.

Economic performance couldn't be stronger, especially in light of the deep hole that President Obama inherited. Well, that is the story that you are going to hear from my colleagues on the other side of the aisle, and they have been telling it for years, but the facts clearly contradict this situation.

The fact of the matter is that we are mired in the slowest recovery since at least World War II.

Historically, our Nation's economy has grown at a 3 percent clip. The Obama Administration now pretends that a new normal of 2 percent counts as a success. Small on its face, the difference between 3 and 2 percent is 50 percent.

Unfortunately, economic opportunities are now disappearing even faster. And while my friends on the other side have been crowing about this recovery for years, Republicans have been calling out for what it really is: completely unacceptable situation.

But today it will be different in at least one important respect. Our colleagues on the other side of the aisle will finally join us in acknowledging that our economy is underperforming. And together we will examine the important role that the Federal Reserve's dis-

tricts play in expanding economic opportunity—a role that is, unfortunately, under heavy attack.

This attack has been brewing beneath the surface for several years.

In late July, the Democrat Party finally made their true objective clear. The party platform adopted at the convention in Philadelphia promises to increase opportunity for all. Instead, it has taken aim at the very foundation of opportunity, in my opinion—that is the governance of monetary policy and the subject of today's hearing.

Democrats have constantly resisted reforms that would modernize the Federal Reserve, bringing much-needed transparency to what most Americans consider an impossibly opaque institution. While such reforms promise increased accountability, Democrats falsely claim that a better disciplined, more predictable, and clearly communicated monetary policy with Congress and the public would somehow jeopardize the Fed's independence.

Reforms such as these included in the FORM Act and the Draft Financial Choice Act would help insulate the Fed from any opportunity-killing political pressures. However, my friends on the other side of the aisle would like to double down on what Dodd-Frank started, co-opting the Federal Reserve district banks by subjecting them to the same politics that has kicked economic opportunity to the sidelines in the name of re-inflating asset prices. Their platform promises to press the pedal to the metal in a drag race to printing money for the politics of those in office.

They now have launched a hostile takeover of the Federal Reserve itself.

And I will note that this is a dual-edged sword that some might benefit now and will rue the day if this were to go through later.

Real economic opportunity cannot return until Washington puts an end to the pretense of knowledge. We cannot promote economic opportunity for all through a monetary policy that targets assets that benefit only some. Oracles from the Eccles Building have been promising to do so for a decade, but where are the results?

I am as fed up as anybody. We are fed up as anybody.

Where is the promised opportunity? How could the Fed have created trillions upon trillions of dollars from thin air in the name of buying questionable assets that they have left us with with not only the slowest economic recovery in our lifetimes, but increased inequality to boot?

I know that a better way is available, one that reverses the increased centralization of monetary policy in Washington's politicized Board of Governors and restores the historic role of district banks as a critical source of local economic information and an institutional source of support for sound monetary policy.

I believe my House-passed FORM Act and the Financial Services Committee CHOICE Act offer a much better way. Instead of doubling down on Dodd-Frank, these legislative solutions bring monetary policy out of the political shadows and into the sunlight of market accountability, and strengthen monetary policy independence by restoring the voice of the district bank presidents on monetary policy matters while subjecting regulatory and supervisory services to congressional appropriations and oversight, where they properly belong.

I look forward to hearing from our witnesses today.

And the Chair now recognizes the ranking member of the subcommittee, the gentlelady from Wisconsin, Ms. Moore, for 5 minutes for an opening statement.

Ms. MOORE. Thank you and good morning, Mr. Chairman.

And good morning to my colleagues and to this distinguished panel.

I so look forward to the tremendous assets that we have here in front of us, Mr. Chairman. And I especially welcome the Honorable Spriggs, who is a very well-educated gentleman from the University of Wisconsin-Madison.

I think that your perspectives are going to be extremely valuable and we thank you for giving us the time here.

The Federal Reserve, as the central bank of the United States, plays an extremely important role in our financial markets and economy, and I think we have seen this post our recession.

It is also very misunderstood. So I actually think that it may be helpful to have had this hearing to discuss the Federal Reserve and the Federal Reserve System.

I will have to admit to you, Mr. Chairman, that I was initially extremely suspicious of this hearing, due to some proposals that I think would disastrously inject partisan politics into monetary policy. And we have heard some of them.

So I think it is interesting, Mr. Chairman, you talked about not wanting to inject politics into the Federal Reserve, since we have heard these cries to audit the Feds, and balancing the transportation budget with Federal Reserve monies, and just your statement today wanting to bring the Federal Reserve into more of congressional compliance.

But short of undermining the independence of the Fed with policy audits or appropriating the budget, I have been open, Mr. Chairman, to you and others about improving the diversity of thought at the Fed.

The Fed was created and established to be independent, and I think that independence has fueled a lot of these misconceptions and misgivings about the Fed. And I think that we ought to and should explore smart reforms that balance maintaining the Fed's independence but that also bolsters public confidence and faith in the Fed.

We have made some tweaks in Dodd-Frank, including having the GAO study—conduct a study and make recommendations on reform. And I think that that is appropriate. And I think the GAO recommendations are a good place to start any conversation on reform. And I also signed onto a letter with some of my Democratic colleagues encouraging the Fed to seek greater diversity.

And with that, I yield back the balance of my time and I look forward to this hearing, Mr. Chairman. Thank you.

Chairman HUIZENGA. The gentlelady yields back. Thank you for that.

Today, we welcome the testimony of Esther George, president and chief executive officer of the Federal Reserve Bank of Kansas City.

And I know you are coming off of a busy August, with the Jackson Hole conclave that was put together. And I know that you met

with a number of folks who are represented here today in the audience.

Jeffrey Lacker, president and chief executive officer of the Federal Reserve Bank of Richmond.

Robert Jones, chairman and chief executive officer of Old National Bancorp, and former Board director for the Federal Reserve Bank of St. Louis.

Mr. William Spriggs, chief economist for the AFL-CIO, and professor, Department of Economics at Howard University.

Chairman HUIZENGA. Yes, Dr. Spriggs.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Dr. Lacker, you are now recognized for 5 minutes.

STATEMENT OF JEFFREY M. LACKER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL RESERVE BANK OF RICHMOND

Mr. LACKER. Thank you.

Good morning, Chairman Huizenga, Ranking Member Moore, and Chairman Hensarling. I am honored to speak to the subcommittee about the governance structure of the Fed's regional reserve banks.

To understand the Fed's structure it is essential to understand the Fed's purpose. Prior to the founding of the Fed, the banking system was often unable to adjust the supply of monetary assets flexibly enough in response to the changing needs of commerce. The Fed was founded to furnish an elastic currency, in the words of the preamble to the Federal Reserve Act.

Clearinghouses, bank-owned cooperatives in larger cities, played an important role in how periodic crises were resolved before the Fed, including the issuance of currency substitutes. But clearinghouses were widely viewed as favoring the interests of large money-center banks.

Reserve banks were modeled after clearinghouses, but with note-issue powers and universal eligibility for membership, the aim being to improve upon the role of clearinghouses in a way that served broader public interests.

A plan for a centralized institution was rejected out of concern about excessive Wall Street influence at the expense of diverse regional interests. Proposals for a government-controlled central bank were rejected as well, for fear the Federal Government would use control of the money supply to resort to inflationary deficit finance.

At the same time, a measure of public oversight was viewed as essential, consistent with Progressive Era thinking. And so the act included a Federal Reserve Board whose leaders were politically appointed.

Thus, the final Federal Reserve Act reflected a balance of competing considerations: a federated set of institutions to provide for representation of a diverse range of geographic and commercial interests with a hybrid public-private governance structure to provide for public oversight but contain potential misuse of monetary authority.

The governance structure of the Federal Reserve is still effective, in my view, because the considerations the founders wrestled with are all relevant today.

The federated structure has benefited policymaking by ensuring that a diversity of perspectives on policy and economic conditions are brought to the table. Reserve banks historically have shown intellectual leadership on topics that initially went against the grain of mainstream thinking but later became broadly accepted. And Reserve bank presidents have a record of challenging conventional views.

In addition, the federated structure has promoted broad regional engagement of the institution across the country, deepening the Fed's understanding of the diverse economic challenges facing American communities.

To be sure, our country's understanding of diversity has expanded since 1913. And it is in keeping with the spirit of our founding that the Federal Reserve has taken the importance of diversity seriously as we have sought to ensure broad representation of views in the formulation of monetary policy, including those associated with disadvantaged communities. I believe our record in this regard, like that of many other organizations in the United States, shows a combination of substantial progress and areas where more can be done.

In addition to bringing diverse viewpoints to bear, the Fed's public-private governance helps our policymaking focus on longer-term objectives.

At times there is a temptation to provide excessive economic stimulus in the short run, and leave the subsequent inflationary costs for future policymakers to deal with. Evidence from around the world, along with our own history in the United States, amply demonstrates that the temptation of shortsighted monetary policies is a bipartisan vulnerability, just as the Fed's founders feared.

For central banks, this implies that meeting-to-meeting monetary policy decisions need to be insulated from short-term political pressures driven by electoral considerations.

But independence with regard to the choice of monetary policy interest rate settings must be paired with strong accountability for the economic results of policymaking over time. And accountability rests on transparent communications, which help Congress and the public evaluate the Fed's performance against its mandate.

The Fed's public-private structure supports monetary policy independence by ensuring a measure of apolitical leadership. The reserve banks' autonomous balance sheets, protected appropriation status, and independent capital stocks all play a role as well by limiting high-frequency interference that might diminish instrument independence.

The presence of bankers on reserve bank Boards is said to represent a conflict of interest since reserve bank staff supervise banks. But strict rules limit bankers' roles; they simply have no avenue through which they can influence supervisory matters.

Moreover, best practice for any Board is to seek members with expertise relevant to the organization's activities.

The Fed's large payment processing operations, for example, make the original rationale for having bankers serve on reserve

bank Boards still valid, in my view. And in addition, bankers are particularly well-positioned to report on economic conditions in their footprints.

In conclusion, while some claim that the Federal Reserve's governance structure is a historical anachronism, the continued relevance of the trade-offs taken into account by the authors of the Federal Reserve Act argues for the continued utility of this finely balanced arrangement that they crafted.

Thank you.

[The prepared statement of Dr. Lacker can be found on page 78 of the appendix.]

Chairman HUIZENGA. Thank you, Dr. Lacker.

Ms. George, you are recognized for 5 minutes as well.

STATEMENT OF ESTHER L. GEORGE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL RESERVE BANK OF KANSAS CITY

Ms. GEORGE. Chairmen Hensarling and Huizenga, Ranking Member Moore, and members of the subcommittee, thank you for this opportunity to share my views on the role of regional Federal reserve banks as part of the Federal Reserve System.

Because the Federal Reserve is an institution that makes decisions of consequence to the broad public, a discussion of these matters is worthwhile. If changes are to be considered, the public should understand not only the congressional intent for its current design, but also the strong safeguards that assure its accountability.

Central banks are unique institutions. They have important responsibilities for a Nation's financial system and economy.

Congress, as it contemplated a central bank for the United States more than 100 years ago, took note of central bank models for the United States from other countries while keeping in mind two earlier attempts at central banking in the United States. Ultimately, it opted for a different approach—one that recognized the public's distrust of concentrated power and greater confidence in decentralized institutions.

The Federal Reserve's unique public-private structure reflects these strongly held views and is designed to provide a system of checks and balances.

Challenges to this public-private design have surfaced throughout the Federal Reserve's history, not unlike they have today. But in the end, our country has remained most confident in this decentralized governance structure.

Criticism of the quasi-private nature of the regional reserve banks was anticipated from the start. Indeed, the Federal Reserve Act leaves no unchecked power in reserve banks.

The politically appointed members of the Board of Governors have oversight authority of the most important governance aspects of reserve banks. For example, they appoint the Chair and deputy Chair of a reserve bank's Board, they vote to approve the selection of the bank's president as well as its chief operating officer, and they approve the reserve bank's budget and salaries.

The Board of Governors also meets with each bank's Chair and deputy Chair annually to review the bank's performance and that of its president.

Finally, the reserve bank's operations are reviewed by the Board of Governors as well as an outside independent auditor.

Notwithstanding this strong public oversight, some question the role of commercial banks within the Fed's structure. Here, too, important safeguards exist.

The supervision and regulation of the Federal Reserve's member banks is a statutory responsibility of the congressionally confirmed Board of Governors.

Bankers who serve on reserve bank Boards are prohibited by law from participating in the selection of the bank president, and no director can participate in bank supervisory matters. Finally, all directors are required to adhere to high ethical standards of conduct and avoid actions that might impair the effectiveness of the Federal Reserve's operations or in any way discredit the reputation of the system.

The capital stock supplied by these member banks serves as the foundation for the decentralized structure, allowing for separate corporate entities. Through the regional reserve banks, private citizens from diverse backgrounds and from the largest to the smallest communities have input into national economic policy. Strong and varied independent perspectives more easily emerge to engage in difficult monetary policy discussions, and the central bank is provided insulation from short-term political pressures.

Altering this public-private structure in favor of a fully public construct diminishes these defining characteristics, in my view. It also risks putting more distance between Main Street and the Nation's central bank.

Former Fed Chairman Paul Volcker understood this well. He experienced firsthand how public pressure can be exerted on a central bank when it must make unpopular decisions that he and the FOMC judged to be in the long-run best interests of the economy.

In a 1984 speech he noted the important role of the structure of the Federal Reserve System in supporting the central bank's decision-making. And he said, "It was all quite deliberately done by men of political imagination, designed to assure a certain independence of judgment, a continuity in professionalism in staff, a close contact with economic developments and opinion throughout our great land, and a large degree of insulation from partisan or passing political concerns."

To that end, I extend a personal invitation for any of you to visit the Federal Reserve Bank of Kansas City to see what a regional Federal Reserve bank provides in support of the central bank's objectives for economic stability.

Thank you. I look forward to taking your questions.

[The prepared statement of Ms. George can be found on page 42 of the appendix.]

Chairman HUIZENGA. Thank you, Ms. George.

Mr. Jones, you are now recognized for 5 minutes.

**STATEMENT OF ROBERT G. JONES, CHAIRMAN AND CHIEF
EXECUTIVE OFFICER, OLD NATIONAL BANCORP**

Mr. JONES. Great. Thank you.

Chairman Huizenga and Ranking Member Moore, good morning. It is my honor to speak with the distinguished members of this committee today about the role of community bankers on our reserve bank Boards.

In my belief, it is critically important that bankers continue to serve in this capacity.

I sit before you as the chairman and CEO of Old National Bancorp, a 182-year-old community bank headquartered in Evansville, Indiana, serving Indiana, southwest Michigan, Wisconsin, and Kentucky. I am also a proud former Board director of the Federal Reserve Bank of St. Louis as well as a former member of the Federal Advisory Committee of the Federal Reserve Board.

I would like to begin my remarks by touching on a partnership that has changed the lives for the better. At its center are two individuals: Roslyn Jackson, a former substance abuse counselor in western Kentucky penal system; and Ben Joergens, Old National Bancorp's financial empowerment officer.

With insights and guidance from Roslyn, Ben designed a financial education program that provides nonviolent offenders in our region with the tools to gain financial independence once they have completed their debt to society. Launched in 2014, this program led the American Bankers Association to recognize Ben with its George Bailey Distinguished Service Award.

More importantly, it has led the nearly 2,000 individuals out of a cycle of despair and dependence that was fueled by their inability to manage their finances. One graduate of the program summed it up this way: "I learned that you can always cleanup the wreckage of your past and take control of your destiny."

This is just one illustration of the many ways that banks big and small work to strengthen the communities that we serve.

Old National is a fairly typical community bank. With \$14.4 billion in assets, we are literally headquartered on Main Street in Evansville, Indiana. Our clients are small and mid-size business owners, farmers, young families, retirees, labor and community leaders. Each year we invest millions in support of community causes, and our nearly 3,000 associates are known for their volunteerism, having donated more than 100,000 volunteer hours in 2015.

In 2016 our company was named to the Ethisphere Institute's World's Most Ethical Companies list for this fifth consecutive year. And recently the American Bankers Association named us as one of the best banks to work for in the country.

The strong connection that banks like ours enjoys with their communities we serve gives us a unique and valuable perspective. Not only do bankers serve as community catalysts, we are on the front lines every day assisting our clients, who represent a broad cross-section of industries and neighborhoods.

Over time we gain vital instincts to how they view the economy and how those views shape their decision-making.

Conversely, the bankers who sit on the Nation's reserve Boards gain incredibly valuable information that they can take back to

their communities. I experienced this reciprocal relationship first-hand during my tenure.

Fueled by the knowledge I gained from my Board experience, Old National spearheaded the creation of the first Bank On program in the Midwest back in 2009.

In the nearly 8 years since we adopted this program we have added another 16 programs in our footprint, helping the unbanked and underbanked individuals take greater control of their finances.

Again, all this dates back to the knowledge I gained serving under Federal Reserve. In my time as a director, I and other bankers on our Board not only brought valuable insights from our communities into our discussions, we frequently reached out to a diverse set of community leaders to gather specific feedback that help drive policy decisions.

Over time these trusted voices from Main Street began seeking us out to offer their views on issues of the day. These candid regional perspectives were invaluable to our discussions on the drivers of our local economies. That is why I feel so strongly that bankers are a vital asset.

I recognize the concerns that have surfaced over whether bank directors might somehow attempt to control or manipulate decisions for the betterment of their own institutions. While no system is perfect, I do believe this issue is effectively addressed through the current policies and procedures of the Federal Reserve System.

As this committee knows, the banking industry is highly regulated and bankers fully understand the consequences if we violate these regulations. These same consequences apply to the regulations and policies that govern the Federal Reserve System. The existing governance model is strong and I applaud the controls currently in place.

I can assure you that during my tenure I never felt that my integrity or ethical center were in any way challenged or compromised.

As banker, our role in the Federal Reserve Board is limited, yet crucial. We serve as managers, budgeters, auditors, and strategic planners. And we supply a vibrant and important regional voice on issues that affect small and medium-sized towns all across our great Nation.

I encourage this committee to retain this vital link to the views, perceptions, and attitudes of mainstream America.

Thank you for your time.

[The prepared statement of Mr. Jones can be found on page 75 of the appendix.]

Chairman HUIZENGA. Thank you, Mr. Jones.

With that, the Honorable William Spriggs is recognized for 5 minutes.

STATEMENT OF THE HONORABLE WILLIAM E. SPRIGGS, CHIEF ECONOMIST, AFL-CIO, AND PROFESSOR, DEPARTMENT OF ECONOMICS, HOWARD UNIVERSITY

Mr. SPRIGGS. Good morning, and thank you, Chair Huizenga and Ranking Member Gwen Moore, for this invitation to speak today.

I want to start with a clear statement that I don't disagree with the current set of policies that the Fed is pursuing. In fact, we are

in uncharted waters when it comes to this recovery because, unlike in the past, the Fed has not had the help of fiscal policy to stimulate the economy. On all previous occasions when we have had downturns Congress has held up its half of the Humphrey-Hawkins Act—to fully address full employment.

When we look at the deficit spending under President Reagan and the deficits that were run up under President George W. Bush we see the Congress clearly understood the need to act and to respond to the downturn. So this is unprecedented for the Fed to have to act on its own, and I would think, as was the case with Chairman Volcker, it has led to a lot of public criticism that is very hard for the Fed. And but for its independence, Chair Yellen could not be steering us in these uncharted waters.

I also want to say that it is fully possible—possible—under the current standards to have regional bank presidents who are quite open to public participation and truly do think that they have to represent and listen to all the voices from their region.

You have President George here on the panel, who has let the doors of her bank open, has left the doors of her bank to engage her community and to talk to all the citizens in her region and hear from those who are affected by Fed policy, and to respect their voices. So it is possible.

I want to give my statements with regard to your theme, which is policy outcomes, and to look back because, of course, we cannot ignore the Great Recession and what led up to it. So that is going to be the tone of what I would like to speak about.

You see the chart that is up now? This shows the record of inflation pre-1978. You already heard about Chairman Volcker and his war on inflation; and then post-1984, what economists call the Great Moderation.

And when you see the chart you can clearly see that inflation averaged a much higher level before 1984; since 1984 inflation has run at a significantly lower amount. But more importantly, the variance in inflation has greatly reduced. So there is great stability that has occurred in terms of price stability.

You can see the green line shows current average inflation post-1984. The red line shows inflation in the period before.

The next slide, however, shows you the performance of the labor market. And here you see a clear difference.

Before 1978 the average monthly unemployment rate in the United States was 5.1 percent. During the Great Moderation it has been 6.1 percent. That 1 percentage point difference means a lot. In the Great Moderation only 25 percent of the time have American workers been below 5.1 percent.

This lack of voice on the part of workers affects the way that the Fed looks at things. And it is not guaranteed into the system.

Class B members often do have influence. The current president of the Philadelphia bank was a class B member, chaired the search committee, stepped down from the search committee and then became president of the bank. There are at least 12 instances in which class B members chosen by the banks have ended up being class C members—those who then govern the regional banks.

The voices of others needs to be put into the mix so that we can have, guaranteed, the voice of everyone.

When the banks were established in 1914 we had a much different banking system. Today the level of concentration in our banking system is at record high levels and that means that we can't think that the regional banks really represent regional views. We need to have a way to assure that that will be the case.

[The prepared statement of Mr. Spriggs can be found on page 106 of the appendix.]

Chairman HUIZENGA. Thank you. I appreciate that testimony.

The Chair now recognizes himself for 5 minutes.

And I would like to point out next week marks the eighth anniversary of Lehman Brothers' collapse. Prominent scholars who studied the financial crisis point to a monetary policy that was too loose for too long as a significant contributor.

Scholars have also shown that the unique institutional structure of district banks can guard against such policy mistakes. That is, district presidents tend to be more concerned about overly accommodative policy than are their politically appointed colleagues on the Board of Governors, while this tendency has been criticized by advocates for extending what is already the greatest monetary accommodation in American history, under the theory that doing so will increase wages and employment at lower income levels.

Research also suggests that we need to do just the opposite. For example, Dr. Christina Romer, a Berkeley economics professor and the first person to Chair President Obama's Council of Economic Advisors, observed that, "Compassionate monetary policy is sound monetary policy." Monetary policy that aims at low inflation and stable aggregate demand is the most likely to "permanently improve conditions for the poor."

President George, do you agree with President Obama's first CEA Chair that sound monetary policy is most likely to permanently improve conditions for the poor? And I am going to asking everybody for just a yes or no.

Ms. GEORGE. Yes.

Chairman HUIZENGA. Yes.

How about you, Mr. Spriggs—Honorable Spriggs? Do you agree?

Mr. SPRIGGS. I think that sound monetary policy includes making sure that the wages of workers rise with productivity, that we are at full employment so that the Nation can have the highest level productivity possible.

Chairman HUIZENGA. Is that a yes or a no?

Mr. SPRIGGS. That is my definition of sound monetary policy.

Chairman HUIZENGA. Okay.

How about you Dr. Lacker?

Mr. LACKER. I agree with Christina Romer's sentence.

Chairman HUIZENGA. Okay.

Mr. Jones?

Mr. JONES. I agree, yes.

Chairman HUIZENGA. Okay.

I do too, and it seems to me that we share a common interest, which is the widening wage gap—the underrepresentation that has occurred for those in low and moderate income who have not seen their wages in increase.

We all know, and if you have watched my subcommittee at all or watched me in committee I have said this many many many

many times, Wall Street is doing just fine. I am concerned about Main Street and what is going on. And you literally, Mr. Jones, are at the corner of Main Street in Evanston, Indiana.

This is something that we have to tackle. And I think that there really is something that the right and the left share, which is a suspicious view of the Federal Reserve and want to make sure that there is a proper check on the Federal Reserve. I believe these district bank presidents do that.

I also want to do a quick—quickly ask, do you agree that the Federal Reserve district presidents bring important regional and local knowledge to the FOMC deliberations?

And, Dr. Lacker and Ms. George, if you don't mind touching on that briefly? You are at the table.

Mr. LACKER. Yes I do. It is an intense focus of every regional reserve bank to understand economic conditions in their district in way that complements the national economic statistics and is more granular and more thoughtful than the statistics that the national level can reveal, so yes.

Chairman HUIZENGA. Ms. George?

Ms. GEORGE. And the transcripts show that a significant portion of the discussion about the economy does come from talking about regional aspects of the national economy.

Chairman HUIZENGA. Actually, I have had my own little experience in that.

My family is involved in construction in Michigan. I own a small third-generation sand and gravel operation. Family has been involved in construction for decades. And that when I went to visit the president of the Chicago Reserve Bank the first 15 minutes of that was an interview of me—what was happening in the local economy in West Michigan.

Given those changes in populations and demographics, does the current rotation of who votes in each FOMC meeting fully leverage the benefits of that regional and local perspectives that can bring to monetary policy?

Again, Ms. George, why don't we start with you?

Ms. GEORGE. Certainly,

So the importance of those regional connections come through access that we have in those district lines through our branch offices, through our Boards of directors on those branch offices. And so I think the country has been covered in terms of—despite demographic changes that span—that each regional reserve bank takes seriously, which is to make sure they understand, within the confines of their district, how that economy is performing.

Chairman HUIZENGA. Dr. Lacker, I will let you have the—

Mr. LACKER. Yes, I think you asked about voting rotation, as well.

So all the participants in a meeting, whether they voter or not, have a voice and do bring their characterization of regional economic conditions to the discussion, and it is part of the discussion. Where voting comes into play is just where is the center of gravity of the committee and where does the Chair finds it useful to find a consensus?

The current rotation was crafted decades ago and altering it would alter the—sort of the balance of forces within the committee. And I will leave it at that.

Chairman HUIZENG. My time has expired, but I will just end quickly and I will have a light gavel with my ranking member, as well.

That is one of the reasons why I felt it important to include in the FORM Act provisions that would bring a more balanced set of district-level views into the FOMC voting process. And we have had such a weighted view towards New York and that permanent seat, I wanted to make sure all those voices are being heard.

So with that, my time has expired.

And I recognize the ranking member for 5 minutes.

Ms. MOORE. Thank you so much Mr. Chairman.

And I do want to thank you all for your testimony.

I think I heard correctly from all of you that you think that the independence of the Fed is really critical toward your being able to do your jobs. Did I hear correctly from all of you?

Ms. GEORGE. Yes.

Ms. MOORE. Yes. So you all agree on that.

That being said, I guess I am concerned about—I guess I want to hear from each of you of what you think of the importance of having a more diverse representation on the Federal Reserve Board. Do you think or do you not think that that would interfere with independence or would that enhance the decision-making process?

I was on a letter with about 100 lawmakers, which asked the Federal Reserve to look at greater diversities, so I guess I would like to hear from each of you just very briefly about whether or not you think that efforts to diversify the Board would interfere with independence.

Mr. LACKER. So we take diversity very seriously. I know that that is a commonplace cliché almost.

But diversity, as I noted in my statement, is built into the structure of the system. And the idea bringing diversities to the table, the value of diverse perspectives in strengthening a decision-making process, is something that predates the concerns of this decade or the previous decade in diversity of access to economic resources and opportunities.

We have been focusing on at the Board—our Board of directors level diversity for several decades now. And I know that we and others have had minority representation, women representation on their Boards going back several decades. It is something that is a regular part of the discussion and regularly reported on within the system.

Ms. MOORE. Thank you, Dr. Lacker. I want to give others a chance to answer this question, as well.

Mr. SPRIGGS. I would say that a problem with having it owned by banks is, regrettably, the Board of directors looked like banks. So they look like the executives of banks: 83 percent of the directors are white; 75 percent are men. These are people who look like bank directors. They are trained and they talk like bank directors.

So it is not necessarily a capture in the usual sense of regulatory capture, but clearly in a cultural capture.

Ms. MOORE. Gotcha.

Mr. SPRIGGS. In the transcripts that you see going up to the crisis, even regional bank presidents who were in regions where the epicenter of the subprime crisis hit hardest had no comments about what was going on in terms of the effect of the subprime crisis on the African-American and Latino community—

Ms. MOORE. With that—

Mr. SPRIGGS. —or an understanding of it—

Ms. MOORE. Dr. Spriggs, my time is limited so let me take you here: There is often a lot of resistance to the bank doing their dual mandate to look at unemployment. And unemployment in the African-American community—African-Americans are not experiencing the recovery as other communities are.

So what do you think about reforms that might—or activities of the bank—that focus on reducing unemployment, especially among African-Americans? Is that something that would interfere with the other mandate to control inflation?

Mr. SPRIGGS. The mandate of the bank actually comes from the Humphrey-Hawkins Act and the clear mandate is full employment. Full employment benefits everyone, and that means full employment for everyone.

Actually, African-Americans employment-to-population ratio has been rising faster than for anyone else. It has gone up 10 percent. The problem is that often the Fed ignores the importance—

Ms. MOORE. Exactly.

Mr. SPRIGGS. —of that trend continuing and often thinks that it can stop recoveries before full employment is actually reached.

When full employment comes we know that workers are better allocated, we get the efficiencies of the labor market at full employment, and discrimination falls. Currently, that is what is taking place. Currently, the gap in the unemployment experience of better-educated African-Americans to less-educated whites is closing, and that is because the labor market is beginning to heal.

But it is not at full employment. Wages are not rise with productivity. We do not see quit rates to show that workers are being re-allocated, and we do not see the level discrimination dropping.

Ms. MOORE. And do you think reformation of the Board and, moving from class D to C or some sort of programming would enable—would inform the Board about the importance of focusing on the full employment part of their mandate if we were to diversify the Fed more?

Mr. SPRIGGS. Yes, because finally the worker's voice would be at the table and the worker's voice from communities that really are hurt the most would be at the table.

In 2010, when the African-American unemployment rate was always above 15 percent, no one mentioned in the transcripts anything about the African-American unemployment rate at the FOMC.

Ms. MOORE. All right.

Thank you for your indulgences, Mr. Chairman. I yield back.

Chairman HUIZENGA. The gentlelady yields back.

With that, the Chair recognizes the vice chairman of the subcommittee, Mr. Mulvaney of South Carolina, for 5 minutes.

Mr. MULVANEY. I thank the chairman.

I am going to try and talk about three apparently different things and see if I can weave them together, if you would give me a second to try and do that.

I heard each of the three of you who have been presidents of the regional feds talk about the importance of knowing your district. I admire and respect that and believe that you are doing that. In fact, I have talked to Dr. Lacker about the district he lives in and he and I share, and I know that he is doing that.

And then I weigh that against my personal experience. I can never forget being at a homebuilder's conference in California in 2006 or 2007, and the keynote speaker one night at dinner was some high-ranking member of the San Francisco Fed. It was not Janet Yellen at the time.

And the subject of his speech that night was that it was the studied opinion of the San Francisco Fed, after having done intensive research, that on a national basis the homebuilding business would never go into recession again, that the restrictions on supply of new housing was such at the local level that we would never see a housing recession again in the country.

So I weigh your efforts to try and know your district with just the human weaknesses of being wrong from time to time and occasionally being wrong on a monumental scale.

Secondly, I would draw to each of the panelists' attention not only a recent article in the Economist magazine, but a scholarly piece of work that was referenced in there. I wish I could read the names. I think it is Professors Cieslak, Morse, and Vissing-Jorgensen—one from Duke and two from Cal-Berkeley.

It goes into a very interesting analysis of what market returns have been in the weeks after the private FOMC meetings, that if you invested a dollar in the stock markets in the week after the meetings your return on that dollar over the—since 1994 would be about 12 times—1,200 percent—versus almost zero if you had weighed it in on every other week, the obvious application being, as the article mentions, that the—and I will read from the article very briefly—that the scholars speculate that there is a causal connection, selective disclosure, which they say is unfair.

Those who attend the meetings have informal contact with the media, consultancies, and financial firms, and eventually the content of those meetings makes its way into the stock market.

Again, I would commend the study to you folks and be curious to know your opinion about it at another time.

It reminded me, by the way, that there is an investigation going on into the leak involving a company, Medley Global Advisors, from several years that is still ongoing, where we know information was leaked out of the FOMC meetings.

Again two things not apparently similar, but I am trying to get there.

Lastly, Dr. Lacker, you mentioned in your testimony something that we have talked about in this committee several times, which is—and I will read from it now—at times there is temptation to provide excessive economic stimulus in the short run and leave the subsequent inflationary cost for future policymakers to deal with.

Evidence from around the world along with our own history amply demonstrates a temptation of shortsighted monetary policies is a bipartisan vulnerability, just as the Fed's founders feared.

For central banks this implies that meeting-to-meeting monetary policy decisions need to be insulated from short-term political pressures driven by electoral consideration.

And certainly my party is experiencing that now. We have a Fed chairman who was appointed by someone of another party, different political philosophy than we then we share. And my guess is my Democrat colleagues may in the future sometime share that same concern if a Republican nominee holds that chair.

What do these three things have in common? It seems like the current system makes it very difficult—that our record of predicting the future at the Fed is fairly poor.

It also seems that there is a risk of market distortions just from us doing things. The scholarly piece doesn't suggest that there is any nefarious activity; it is just a casual connections.

Lastly, you have the risk of political pressure from either side on the Fed. Why? Because they are people and they are appointed by other people, and there are human tendencies here.

So my question to all of you is this: Doesn't a rules-based approach to monetary policy lessen the possible distortions to each of those weaknesses? Doesn't it take away and make it less important if we make big mistakes in terms of our predictability? Doesn't it lessen the likelihood that information is selectively distributed to the market so that some people can benefit and others do not? And doesn't it lessen the likelihood of political pressure?

Doesn't a rules-based system, whether you are conservative, liberal, Republican, Democrat, solve a lot of the problems that we face at the Fed?

I will asked Dr. Lacker and then Mr. Spriggs.

Mr. LACKER. Sure. We consult rules very regularly. I think having a sense of the pattern of past behavior of your own institution that gave rise to good outcomes is an important benchmark, and I gave a speech about this last Friday.

I would caution on—I draw the parallel between the search for the right rule and the San Francisco Fed study you cited, which was clearly obviously well-meaning. They believed their results sincerely, but there was some measure of uncertainty to the conclusion they drew, and I think you would have to attach some measure of uncertainty to what you chose as the optimal rule.

And for that reason I think it is useful to sort of back away from a rule, consult it as a guide to good policy, but not follow it mechanically or slavishly. But I do think it is important to give prominent attention to rules that encapsulate good past behavior in our conduct of monetary policy, and we do that.

Mr. MULVANEY. Professor Spriggs?

Mr. SPRIGGS. I am sympathetic to your point. However, the Fed has limited tools to influence the economy. The problem is that many of the problems are more complex and can have counterbalancing effects. So I don't think in all situations you would want them to adhere to the rule. The rule, in fact, may be not the best policy.

For farmers right now the problem is an oversupply of commodities and this hurts them. The value of the dollar hurts our manufacturing sector.

So there are many things that are moving at the same time, and I think you wouldn't want a rule that would bind the Fed in dealing with how those different—

Mr. MULVANEY. I thank you, gentlemen.

I thank the chairman for the indulgence.

It sounds like the two gentlemen may not be that far apart, but I appreciate the time.

Chairman HUIZENGA. Thank you.

The Chair will note again, I have a light gavel. But 4-minute-and-40-second questions might not leave a whole lot of time for answers.

Ms. MOORE. It took him a long time to ask the question. Let me defend my colleague.

Chairman HUIZENGA. With that, the Chair recognizes Mr. Foster of Illinois, for 5 minutes.

Mr. FOSTER. Thank you Mr. Chairman.

And thank you, to our witnesses here.

It seems to me that a big part of the diversity challenges of the Fed System are driven by the fact that the geographical regions of the Fed districts are very far from representative of today's population distribution or, in fact, the GDP distribution, or however you might assign the regions.

This, to my mind, is a huge problem in the distribution of legislative power in our country. Just the fact that the Senate is grossly unrepresentative of the actual population distribution of the States results in about \$.5 trillion per year wealth transfer from the high-population States, which are underrepresented in the Senate, to the low-population States, which are overrepresented in their power in the Senate, and the huge economic distortion to our country that costs us a lot. I know it costs my home state of Illinois about \$40 billion a year and is the primary driver of our fiscal difficulties.

So I was wondering what your reaction would be to a proposal, which has been floated from time to time, to periodically redistrict the Fed System perhaps once a century, and with enough decades of the time that you would actually have time to plan and it wouldn't be disruptive?

How big a problem do you think the male distribution of political power inside the Fed is to its current operation? And do you think it would net out positively to redistrict the Fed every century or so?

Ms. GEORGE. I don't think that we are handicapped by the current district lines, notwithstanding the changes in demographics that you have described over the last 100 years. And the reason I say that is because each region, regardless of how its boundary is defined, is focused through its operations on making sure that it understands every part of that region.

And so the Federal Reserve works carefully—as we do in Kansas City—to make sure that all parts of that region are not only represented, but we understand the economic issues there.

Mr. FOSTER. That would be true with or without redistricting. That is a separate issue than presumably if you redistricted things

every district would represent the interests of whoever—whatever people and banks were in its district.

Ms. GEORGE. I agree.

Mr. SPRIGGS. And I would offer that it appears that way, but over time some of the district lines have been redrawn. So Detroit once was represented by Cleveland and now Detroit is with Chicago, as the whole state of Michigan is. So fine-tuning—

Mr. FOSTER. At present I think there is still something like a factor of six difference in the number of people in different Fed districts, which is a big number.

Mr. SPRIGGS. Yes, but I think more important would be an assurance that the people of the district actually were represented. The issue now is that the banks are represented.

So I think an issue is, how can we make sure that the people themselves are represented? How do we make sure that an actual farmer in Illinois is represented, not some giant agricultural chairman of some huge corporation? How do we make sure that the workers on the south side of Chicago are represented? Because these policies affect them and their voice needs to be integral to it.

Currently this is at the whim of the banking community whether those voices really factor into the decision-making because those people aren't on their Board—aren't on the Boards of the regional banks.

Mr. FOSTER. Yes. I was very struck by a study paper from I think one of the Federal Reserve study groups talking about fiscal hawks and doves. And if you look at the course of a cyclical downturn and the choice that the Fed faces of maintaining constant inflation or constant employment, that if you focus on constant employment it has real distributional advantages to those at the bottom. And conversely, if you choose to optimize the other way.

And so I think this is a fundamental reason—fundamental argument for diversity, that there are real distributional effects because of the intrinsic trade-offs that the Fed has to make.

Just a final comment or a question on rules-based system. If you did go to a rules-based system it seems like the sort of rule you would need to realistically represent our—today's economy would include GDP growth in China and every major country in the world as a fundamental input to that. So you are not talking about a simple Taylor Rule; you are talking about a very involved macro-economic model, which I take it exists, but really sort of hard to specify in legislation.

Wondering if you had comments on that complexity trade-off?

Mr. LACKER. Sure. In the models we have that capture economic—the economic economy—economic activity pretty well, implementing a Taylor Rule gets very close to the optimal rule that would be dependent on a broader range of things. So, it is an empirical matter whether that is true or not, but in the models we have it looks as if the Taylor rule does—gets you fairly close.

Mr. FOSTER. Prior to the Taylor Rule there was another economist whose name I forget who actually had a more complete and general version of the Taylor Rule that obviously, because it had more parameters, did a better job. It is not an argument that started with the Taylor Rule.

Mr. LACKER. Right.

Mr. FOSTER. Okay.

Well, I will be a rarity and only be a little bit over time here and yield back.

Chairman HUIZENGA. Thank you, Mr. Foster. I appreciate that. The Chair recognizes Mr. Lucas of Oklahoma for 5 minutes.

Mr. LUCAS. Thank you, Mr. Chairman.

And for my time, since I am a resident of the Kansas City Fed, I would like to turn to President George.

And my colleague just a moment ago, with his observations about realigning the districts, touches on a subject that to you as a historian as well as a CEO know goes back not just the beginning of the Fed but to the very beginning of this country—about where the concentration of capital should be and control over the economy and how that capital flows.

From the very beginning the great battle was should the money centers—New York, Chicago—should they be the dominant force? I suspect that is why my predecessors in this Congress a century ago demanded the 12 districts and the lines be laid out the way they were, to protect the entire country from a handful.

Now, that said, this is an issue that is not just theoretical; it is a real subject. In 2009, when I was the ranking member of another committee with jurisdiction over the derivatives markets, in a meeting one night a senior Administration official brought up the topic of realigning Feds as we were preparing to launch in the Dodd-Frank.

Taking the 12 districts, did we need that many? Shouldn't the districts reflect the economic strength of a particular region? Now, rather quickly both Republicans and Democrats, House and Senate members in that meeting, made it clear to the senior official that that was not a topic that was acceptable at the time of the Congress.

But even as recently as 2009 it was a subject of real debate, apparently at the highest levels of the Administration.

Now, that said, from my perspective I like not only the 12 Feds, but I like the sub-Feds. I like the groups in our district in Denver and Oklahoma City and in Omaha who act as consultants, advisors. Could you expand for a moment on the involvement in those communities within the Kansas City Fed, President George, how they add to the process?

Ms. GEORGE. So the branch offices for each of the head offices play very important roles. And in the case of the Kansas City Fed, I rely heavily on the input from those branch Boards—for example, in the state of Oklahoma to help me understand what is happening in energy markets, and our Omaha Board to understand what is happening in agriculture.

And the diversity of input that comes onto those Boards serves us well in the head office. So that sort of regional input is essential, in my view, to make sure that all parts of that district are well-understood.

The regional economists who head each of those offices are out in those communities engaging on a daily basis with those that affect that economy and are affected by it. So that structure has served us well.

Mr. LUCAS. So even though you don't clear checks anymore and those regional banks aren't big currency repositories and you don't grind up wore-out paper money they still serve a purpose, correct, Madam President?

Ms. GEORGE. Absolutely. The Federal Reserve has changed dramatically in its operations, but its commitment to those regions remained constant over that time.

Mr. LUCAS. Side question deviating just a little bit from the subject matter, but your district is manufacturing, of course; it is agriculture and energy.

We seem to be under pressure these days in the Kansas City district in all three areas. How much concern do you have as an economist and as a banker with the circumstances right now in your district?

Ms. GEORGE. So we have seen over the last 6 years, a clear shift in the economies of that region based on commodity price falls. So the drop in oil prices, the fall in agricultural product prices, and the strong dollar on our manufacturing have affected that region significantly.

So today we do see more unemployment; we are seeing flatter growth, although some sectors are still growing. So those are important inputs as we look at that region relative to the performance of the national economy.

Mr. LUCAS. So it does matter having eyes and ears all of the country. Thank you, President George.

I yield back, Mr. Chairman.

Chairman HUIZENGA. The gentleman yields back.

With that, the Chair recognizes Mr. Perlmutter of Colorado for 5 minutes.

Mr. PERLMUTTER. Thank you.

And, President George, you are going to get some questions from me too, although Mr. Lucas stole a few my questions.

Let's just go back to basics. How many directors are there for each of the regional banks?

Ms. GEORGE. There are nine directors.

Mr. PERLMUTTER. Nine. And what are the basic requirements of those nine directors?

Ms. GEORGE. The first requirement is integrity.

And, of course, beyond that there are three bankers, there are three businesses, and there are three that are selected by the Board of Governors. So six of those nine represent labor, represent community, represent generally what is reflective of the region in that district as well as the three bankers on our Boards.

And in the case of the Kansas City Fed, those three bankers are community banks. They are individuals who connect tightly with many aspects of meeting the credit needs of our region as well as community leaders that we have in our class B category and on our class C directors.

Mr. PERLMUTTER. Okay. And this applies to all of the regional banks?

Ms. GEORGE. The—

Mr. PERLMUTTER. Nine directors for every one of the regional banks?

Ms. GEORGE. Yes, yes.

Mr. PERLMUTTER. And similar kind of criteria—I was looking and it seem like it was agricultural, industrial, commercial, and financial seem to be the basic core principles and noticed, looking at your website, you have these regional kind of Boards within your regional bank. So you have a head office, a Denver office, an Oklahoma City office, and an Omaha office.

And Dr. Lacker used the terms, “everybody is looking for diversity.” So to the two of you I would say, “Okay, what the heck does that mean to you?”

I’ll start with you, President George, and then to you, Dr. Lacker. What you mean by diversity?

Ms. GEORGE. So diversity is built into an institution like the Federal Reserve, who is serving a broad public. And it is essential to the public’s trust in this institution that the public sees themselves around those that are making decisions and have input to policy.

Mr. PERLMUTTER. So do you mean—and this really applies to both of you—and, Mr. Jones and Mr. Spriggs, jump in if you wish—does diversity mean ethnic backgrounds? Does it mean level of income? Does it mean regional diversity? What does it mean?

Ms. GEORGE. It means all of that.

We will not be successful without having ethnic diversity on our Boards, without having the interest of labor represented on our Boards, as well as the multifaceted contributors to that economy, whether they are business, ag, energy. So we look broadly at all aspects of that.

Mr. PERLMUTTER. All right. Dr. Lacker?

Mr. LACKER. Yes. I agree with how President George characterized it.

There are multiple dimensions on which when we are looking at rounding out a Board we look at. Ethnic diversity is certainly one of them, gender.

But we are also looking at diversity within our region. Our region goes from South Carolina to Maryland out to West Virginia. Very diverse economies. We want representation from around the region.

We want coverage across different industries. We want some representatives of someone in touch with consumers and consumer groups, labor. All of those perspectives are valuable to us and we try and balance that when putting together a slate.

Mr. PERLMUTTER. Mr. Jones?

Mr. JONES. If I could just add, I think that is one of the key roles that commercial bankers play towards diversity because diversity is race, it is religion, it is—but it is also neighborhoods, it is also communities.

And if you think about the Bank On program that was started, it was really driven through the Fed to say, how do we better serve the underbanked and unbanked? And that is really the key role that bankers play because we have a moral obligation to ensure that all of our communities are served.

And as we sit on the Fed Boards, our primary focus is to make sure those voices are heard. So as you prepare for meetings you talk to folks from the underbanked and the unbanked all away to the GM running Toyota, and you bring those voices to the Fed and say, “Here is what we see and what is going on in our markets.”

And that is what is so critical for us as a commercial banker because we are one of the few industries that see everything, and that is the value we bring—

Mr. PERLMUTTER. Let me ask Mr. Spriggs the same thing.

Mr. SPRIGGS. Regrettably, there are only three labor members among the 12 regional banks. So considering the importance of workers and workers as consumers, I don't think the current system gets us the kind of diversity that we need.

In the entire history of the Fed, no—zero—African-American or Latino as ever been chosen to be president of a regional bank. So I don't think the system is designed—it looks like bankers, it talks like bankers, it is people bankers are comfortable with.

Mr. PERLMUTTER. Okay.

Mr. SPRIGGS. But it doesn't have a built-in way to assure it.

Currently, we do applaud the Fed for paying attention to this and trying to address it, but there—

Mr. PERLMUTTER. All right. My time has expired. I got it, and I thank you for your answer.

And I thank the panel for appearing today.

Chairman HUIZENGA. The gentleman's time has expired.

The Chair recognizes Mr. Schweikert of Arizona for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

This is one of those occasions that there is just so many things to ask and we will try to do this with a little caffeine in our soul and go quickly.

Doctor, I want to make sure I got my head around something you said before. It was a comment of fiscal policy, meaning stuff we do here. And the overtone I was picking up saying, hey, you know, there is all this monetary liquidity out in the system but you guys on fiscal side, you need to put more cash into the system. Was I misunderstanding that? Because was it—

Mr. LACKER. It was Dr. Spriggs.

Mr. SCHWEIKERT. Dr. Spriggs.

And my reason for that is even in this year we are going to push up close to \$600 billion of deficit spending in a year where just a couple years ago our projections were, "Hey, we are only to be about \$245 billion to \$265 billion this year."

So somewhere here we are deficit spending like crazy, which functionally is a type of liquidity in the system. We are borrowing money, putting out the door—plus the accommodative.

Can you really make an argument that there is not enough liquidity put out in the society in a world with almost zero interest rates? Was I mishearing what you were saying here?

Mr. SPRIGGS. No, you weren't mishearing, but it is not putting liquidity; it is actually putting demand into the system.

Mr. SCHWEIKERT. Okay, so—

Mr. SPRIGGS. So at the current rate that we are going we are not getting the level of investment that we should, and that is because we have not had our state and local governments in a position to take advantage of the current low interest rates. They have—

Mr. SCHWEIKERT. So let's backup because—okay, demand in the system. Does demand in the system come from more—saying, "Let's go borrow more money and go build something," or does de-

mand in the system ultimately come from the regulatory—the environment we have created here?

And a good example would be when we look at some of our environmental rules, I can come to you with a way saying, “You know if we crowd-sourced much of this data we could clean up the air, do it cheaper, do it faster.” But instead we still engage in this regulatory model, which is a command and control put in paper and file cabinets, and say that is good environmental policy. It doesn’t have anything to do with cleaning the air; it has to do with office buildings full of people shoving paper in file cabinets.

Some of our labor policies—some of these things—if you wanted fiscal policy to increase demand, don’t we need to be doing a series of things where we rationalize some of the crazy regs we are in—whether it be labor, whether environmental—all the way down to some the creative destruction aspects that actually create new lines of economic growth—that we have created barriers of entry?

Is demand available out there not from a bastardized helicopter money, which all of those are sort of involved in, and actually it is a regulatory arbitrage that we need to move through?

Mr. SPRIGGS. The demand is the drop in investment that we have seen, and it is not picking up in the private residential sector, and it is not picking up in the public sector.

Mr. SCHWEIKERT. But how can you—

Mr. SPRIGGS. So we know we are down in terms of pupil-teacher ratios. We have let go hundreds of thousands of teachers—

Mr. SCHWEIKERT. No, no, no, hold it—

Mr. SPRIGGS. —and that investment is necessary both for our long-term—

Chairman HUIZENGA. The gentleman from Arizona controls the time.

Mr. SCHWEIKERT. Hold on for one second. That doesn’t—in a line where I have gone a decade now with falls in productivity, how do you equate, just in those couple of statements of teacher-pupil ratios, with the fact of the matter is capital isn’t moving into acquisition of things that make us more productive?

Mr. SPRIGGS. Education does make us more productive. It is a foundation because workers have to be trained and have to be trainable. And so de-investing, as we have done, because our public sector had to live through not having the lender of last resort. They have downsized their operations to a smaller size.

Mr. SCHWEIKERT. That is not even—

Mr. SPRIGGS. And so we have to invest in our people. We have to invest into higher education, which we have de-invested in, and we have to invest in their K to 12.

Mr. SCHWEIKERT. But that is not what the data actually says. The data says, “Hey, embrace online learning, embrace apprenticeship programs, embrace these things.” And yet, we have a regulatory barrier right now saying we can’t do that because it is not collectivized, it is not unionized, it is not those things.

I hope there is a second round because in many ways we have to be willing to tear down many of the very bureaucratic structures right now that have been built that actually stop the very thing you and I want to see, which is more demand, more productivity.

And you can't say that I want to support the very institutional bureaucratic structures that have been there for years that are dysfunctional in a modern, data-driven—where this is the driver of the economy, not a mechanism that was designed in the 1930s.

And with that I am way over time. Thank you, Mr. Chairman.
Chairman HUIZENGA. The gentleman's time has expired.

The Chair recognizes the gentleman from Washington, Mr. Heck, for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

I also want to express my appreciation to the panel for your presence here today.

I want to go back to briefly a line of questioning the Dr. Foster pursued, which was population maldistribution, and preface my remarks by calling up one of my favorite adages, namely the two most powerful forces on the face of the earth are compound interest and the status quo. And the latter point certainly seems to be at operation here.

What I heard said in answer to the question of whether or not we ought to reexamine the population distribution among Fed districts was it would make a difference. Things are fine as is, i.e., let's not dink with the status quo.

But I guess I want to pose a question in a slightly different way, which is does anybody on the panel genuinely believe that if you were starting from scratch to design the Federal Reserve system and you had any X number of Federal Reserve districts in mind—let's use an arbitrary number, 12—would it look anything—can you honestly say it would look anything like it currently does?

Ms. GEORGE. I think it is fair to say that if you were starting today it may not look like that. It may be that every state would want its own regional reserve bank and you would have more.

Mr. HECK. Well—

Ms. GEORGE. Your point I take, which is the world looks different today than it did 100 years ago.

Mr. HECK. —103 years ago.

And with all due respect, the largest Federal Reserve district now by population is more than six times larger than the smallest. And I dare say that its GDP is probably 10 times greater than that smallest one.

I actually like what Mr. Jones said very much, which is diversity includes reflecting the neighborhoods and the communities. I don't know how you can achieve that without some semblance of a more balanced population distribution.

Dr. Spriggs, I want to ask you about this underlying issue, the elephant in the room, if you will, the hawk-dove issue. It is my reading of history that if you look back over the last 25 years the Fed has actually been involved in the achievement of its full employment goal exactly 60 months out of 25 years.

They have generally had more tangible targets in that regard than on the inflation side, but I think it is fair to say that they have been more effective on the inflation side. I think it is, therefore, fair to say that they have been much more willing to put their foot on the brake on inflation than their foot on the gas pedal to achieve full employment, as evidenced by the data. Would you agree, sir?

Mr. SPRIGGS. Yes, I would, and I—my third slide emphasizes one good product of full employment. A condition for wages to rise with productivity is we have to be at full employment so that we get the allocative efficiencies of the labor market so that workers quit low productivity firms and move to higher productivity firms. That really can only happen once we have full employment.

We have other institutional factors that help to make that happen. But when you look at that third slide that I had you see that productivity continued to grow but wages don't.

And when you don't have full employment you don't have the competitive forces that the labor market can bring to bear on making sure that we get as much out of workers but they also make something that reflects it. And so we all benefit.

The best policy—and the reason Congress passed the Full Employment Act in the 1940s and reemphasized it under the Humphrey-Hawkins Act—the best policy is for Americans to be at work. That means all Americans need to be at work.

The workforce is greatly diversifying. In a few years the majority of new entrants to the labor market, beginning in—beginning at 2021—

Mr. HECK. Dr. Spriggs, I have 13 seconds.

Mr. SPRIGGS. Yes, so—

Mr. HECK. And I want to get another point in here—

Mr. SPRIGGS. —will be workers of color. And so it is important that we—

Mr. HECK. I still want to get another point in here, which is I think—and have said so on this committee at hearing after hearing—that it is time to reexamine how we measure full employment, that the continued use of the U-3 measure is inadequate in the wake of the Great Recession, that U-6, which takes into account part-time workers who want to be full-time and some more discouraged workers, is still stubbornly at just under 10 percent, and that if we are measuring achievement of our goal of full employment as we traditionally have in U-3 then we are missing the boat and, in fact, not achieving what it is we should.

And I appreciate the chair's indulgence very much. Thank you, sir.

Chairman HUIZENGA. No problem.

With that, the Chair recognizes the gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

Thanks, each of you, for being here today. Fascinating discussion.

So I am going to follow up a little bit on what the gentleman from Washington was just talking about. You just got back from Jackson Hole, and if you are looking at the full employment mandate, what is the sense of all the members? Are they pretty satisfied with the 5 percent unemployment? Are they concerned?

Mr. Jones, I will just take you out on—you got an opinion about how—what the outlook was about the employment—the full employment mandate?

Mr. JONES. I can only speak to the regions that we serve. Again, Indiana—

Mr. PEARCE. You didn't go to Jackson Hole?

Mr. JONES. No. I didn't get invited.

Mr. PEARCE. Anybody on the panel go to Jackson Hole?

Ms. GEORGE. Yes.

Mr. SPRIGGS. Yes.

Mr. LACKER. Yes.

Ms. GEORGE. So the focus of Jackson—

Mr. JONES. So I was the only one that didn't get invited.

Mr. PEARCE. You didn't read the online comments or anything?

Ms. GEORGE. The focus of Jackson Hole was on looking at monetary policy frameworks for the future across global central banks.

The issue that you raise, though, is one that is routinely discussed at the FOMC meetings to understand how are the labor markets performing in the economy today, and judgments about how close we are to full employment—

Mr. PEARCE. So what is the judgment? Fairly close—5 percent is okay?

Ms. GEORGE. I believe we are at or near full employment.

Mr. PEARCE. Okay. So when you reverse that mirror then you look the other direction then we see a labor participation rate of 62.8 percent.

So we are saying, in your words, we are near full employment, so 62.8 percent, which is back—you have to go back to the 1970s to get a labor force participation rate at that level. You and the Federal Reserve are saying that this is as good as it gets.

That is alarming because I see the difficulty of spreading the cost of the government between fewer working participants, and it is alarming that this is as good as it is going to get.

You put that up against the 1.1 percent rate of growth and then you get into the monetary policies.

And so, Dr. Lacker, you mentioned in your more expanded paper that the Fed was created to furnish an elastic currency. And so when I go to my town halls my seniors tell me, "We lived our life correctly. We paid for our house. We put money into secure investments. We saved. And now, then, you are making our savings worth nothing because we get nothing, and the value of our house is down to 50 percent what it was before 2008. Your policies are killing us."

And so this this function of creating this elastic currency, as you are talking about—do you all ever sit behind closed doors and ask yourselves quietly what the hell are we doing this for?

Mr. LACKER. That hasn't happened in my experience.

Monetary policy is a blunt instrument. Its capacity to influence real economic activities is quite limited. I think it was true at our founding, I think it is true now. I think we are all painfully aware of that.

When I look at the graph that Dr. Spriggs put up of the unemployment rate going back over the last 50 years, several of those recessions were not recessions we could have prevented but we were left to cope with. Some of those recessions we did cause.

Mr. PEARCE. Yes. I was asking more about the effect of the elastic currency on the lives of seniors especially, but on the lives of people in the poorer States. My district is one of the poorest in the Nation.

Mr. LACKER. I understand.

Mr. PEARCE. So when the price of food goes up because of this elastic currency it hurts our constituents—my constituents—worse than any other. And I was just trying to get—I didn't want all the history. I just was trying to get, do you ever talk about the effects on the poor and the effects on the seniors of these policies? That was my question, if you want to try it again. I am running out of time so I really do want to ask one more—

Mr. LACKER. I apologize.

Mr. PEARCE. The—

Mr. LACKER. The answer is yes, we do, so.

Mr. PEARCE. Okay. Thank you.

So the idea that you have information on local economies—I met with the Federal Reserve branch in El Paso just last week or the week before. They have the correct information.

In other words, the thing that troubles most employers in our district is they cannot find workers who will show up for work. Yet, when I asked Janet Yellen personally about this she said she had no knowledge.

So if the information is not going to be transmitted from those branches who are out there tracking the specific problems of the economy, what difference does this all make anyway?

Ms. GEORGE. We do bring forward that information. And I think the anecdote that you described is one that I hear regularly in the region, and it gets to understanding what is it that monetary policy can affect and what are more structural issues that will require other sorts of policies to affect?

The one you described, I would argue, is one that will have to have other remedies brought to it, as opposed to low interest rates.

Mr. PEARCE. Thank you. I see my time is exhausted. I appreciate the answers.

Chairman HUIZENGA. The Chair now recognizes the ranking member of the full Financial Services Committee, Ms. Waters from California, for 5 minutes.

Ms. WATERS. Thank you very much.

I would like to address a question to Dr. Spriggs.

Dr. Spriggs, in your testimony you discuss how African-Americans continue to suffer from overt employment discrimination. As concrete evidence of this fact you point to evidence that the unemployment experience for better-educated African-Americans is worse than the unemployment rates for less-educated whites.

To what extent can and should the Fed take such discrimination into account as it sets monetary policy?

Mr. SPRIGGS. First, thank you, as the ranking member of the full committee, for joining us.

When we look before the Great Moderation the unemployment experience of blacks with more education looked like the unemployment experience of whites with more education. And there was a significant closing of the gap that occurred between the passage of the Civil Rights Act and as we came into the late 1970s, so much so that if you looked at young men who were college-educated there was virtually no difference between being black or white. And that gap was shrinking for other African-Americans with less education.

Once we went into our high unemployment of the 1980s when the black unemployment rate never fell below 11 percent for the

entire decade, that gap grew for all levels of education and has remained. And so that gap can close. We saw in the late 1990s as we did push towards full employment and the Fed allowed the unemployment rate to the fall and did not intervene, despite a lot of people thinking that they needed to be more worried about inflation.

By letting the labor market tighten we saw once again the power of competition in the labor market to reduce those disparities.

So if we are at full employment—and the Humphrey-Hawkins Act clearly anticipated that market forces could address discrimination. It is one of the findings in the act itself. And you knew Congressman Hawkins as well as I did, and he meant full employment.

His language, the preamble, talks about full employment, full opportunity for useful paid employment at fair rates of compensation. It is way down at the bottom that there is a sentence about reasonable price stability. These aren't on equal footing.

The preamble of that act says full employment and then these other things should be considered. And full employment gets us a lower rate of discrimination.

Ms. WATERS. That is very interesting. Thank you.

And I think that we on this committee who are concerned about full employment should pay attention and engage the bank—the Feds on this. And you are absolutely right. I knew Gus Hawkins and he was very serious about it.

As a matter fact, when I was first elected to office here it was in the seat that he held. With reapportionment that has changed somewhat, but I have an appreciation for how you have helped us to understand what we need to encourage the Feds to also set some priorities for and take into consideration.

But let me thank the Feds for something that may not mean a lot to a lot of folks—the recent meeting in Jackson Hole, where FYDP was invited to participate, was extremely significant and I have a great appreciation for that. Thank you so very much.

With that, I yield back the balance of my time.

Chairman HUIZENGA. The gentlelady yields back.

The Chair recognizes the gentlelady from Utah, Mrs. Love, for 5 minutes.

Mrs. LOVE. Thank you.

I believe that the United States House of Representatives is the branch of government that is closest to people. And hearing the concerns on both sides of the aisle on the structure of the Federal Reserve System is a concern of mine, also.

And if you couple that with the FOMC structure and the interests and the economic priorities of Americans, especially in western States like Utah, with the answers that have been given I am still not convinced that the western States are represented as well as the eastern States.

So with that thought and knowing that concern, I don't think it is enough to just say, "Well, we believe that it is working well," because you do have members on both sides of the aisle that are expressing concerns. And I happen to agree with those concerns that they are expressing.

So I guess I would like to know what you think might be done to rebalance the Federal Reserve System to make sure that all

Americans are equally representative—represented in monetary policy discussions?

President—do I call you President George? Is that okay?

Ms. GEORGE. So your question is an important one for the Federal Reserve. And as I have listened to this discussion I remain convinced it is a question of accountability and not of the structure of the Federal Reserve.

So in the case of the western States, I happen to have a few of those in my region—Wyoming and Colorado, the northern part of New Mexico—we are intentional in picking up information. In fact, today you will see coming out of the beige book, which is released by the Federal Reserve, a sense of each region, which directly includes those kinds of—

Mrs. LOVE. Okay, so I guess the question I am asking is that I know that you are convinced that it is working. But, like, the reason why I mentioned the House of Representatives being closest to people is that every single one of us are talking to our people. We are talking to our bankers, and they share those concerns also.

So again, I know that you feel as if it is representative, but I am trying to look for different ideas where that thought—they may feel like they are being more represented. Yes?

Mr. LACKER. So an important thing to keep in mind is that, although the Federal Reserve, as we have described, is deeply engaged in understanding the entire country, we have just one monetary policy for the whole country. The set of interest rates we set at the FOMC apply to—in financial markets and they set monetary conditions for the whole country.

So while President George or President Williams from San Francisco or myself can go and explain what conditions are like in our district, it is still—as in this body, we have to make the case that it is good for the country as a whole, one policy change or another.

So there is a matter of understanding and then there is a matter of what tools do we have?

Now, here in this body you have tools that can address things in one particular district or another. We do not have that. We do not have a way to target monetary policy to a particular region.

Mrs. LOVE. Okay. So if all else were equal, why—what difference would it make, then, if there were—not to say whether I agree or disagree with this—but if there were more representation on the western side then that shouldn't change things either then?

Mr. LACKER. Well—

Mrs. LOVE. If that is the argument that—

Mr. LACKER. So in my view, the question was asked earlier, if we would—what our prediction would be fore how the districts would be drawn were they to be drawn again today, and I think it is a fair prediction that they would be different.

Would we be worse or better off in terms of how the Fed engages? I think we would be about the same, and I think this goes to the way Esther George framed it, which is that the structure doesn't impede us. We would probably be as good as we are now, perhaps better. But it wouldn't make a big difference, in my mind, for the degree to which we are connected.

Mrs. LOVE. Of course I end up with about 30 seconds.

But, President Lacker, just to switch gears very quickly, you—in one of your speeches, Investing in People as Economic Growth Strategy, I just want you to give a brief description on why district bank presidents would be interested in workforce development and why that would be a good thing.

Mr. LACKER. So when I look around my district Carolina is deeply affected by manufacturing and the like and what has gone on in the last couple of years. It is hard to think about economic conditions without thinking about workforce and labor markets.

And when you think about how labor markets work and what kind of transformation the Carolinas have gone through, for example, it is hard not to think hard about skills, and then you are thinking about, well, how do people acquire skills? How does the changing demand for skills affect people's choices? What can we do to enhance the rapidity with which our labor force adapts to the changing mix of skills that our economy seems to need?

Mrs. LOVE. I am out of time. Thank you.

Chairman HUIZENGA. The gentlelady's time has expired.

And speaking of the Carolinas, the Chair recognizes Mr. Pittenger of North Carolina for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

President Lacker, thank you all for your attention and participation with us today.

But, President Lacker, I would like to ask you in your testimony you spoke about the Federal banks and the representation they have supplied from various interests in diverse regions of the country. I happen to be from Charlotte. We are certainly in your district.

Can you walk me through how the Fed, as a fully public institution, would affect the American public and the economy?

Mr. LACKER. How we affect the American public and the economy?

So it is paramount to keep inflation low and stable. I understand that maximum employment is part of our mandate, but keeping inflation low and stable is our best way of achieving that.

The recessions of the 1970s and the early 1980s were deliberately engineered by the Fed, essentially, in response to spikes in inflation. We are very concerned about that when we are thinking about, are we at full employment? Is there a chance that we have gone beyond it? Is there a chance that we are approaching going beyond it?

Because the risk of overstimulating the economy is the risk that inflation—expectations and inflation get out of control. It may be an unpopular notion these days, but if that were to happen it would be hard for us to calibrate a response without risking causing a recession. And I would point out that in recessions minority groups tend to do very badly.

Mr. PITTENGER. With that in mind, I guess I would ask you, with the Fed's extraordinary policy stance that has been in place now for a full decade, what—has it produced the robust economic growth that we have since—seen since post-World War II? That has been the norm in the country. Give me an explanation for why you believe that is true.

And I will go down the line. I would like all your perspectives on that.

Mr. LACKER. So there was a discussion of labor force participation earlier.

The fraction of the working-age population that is looking for work or is employed has fallen. We are no longer benefitting, as we did in the second half of the 20th century, from the increasing engagement in women in the labor force.

The rate of growth of productivity has fallen, as well. This is the byproduct of a confluence of forces, including capital formation. Neither of those is under the direct control of the Federal Reserve, I would point out.

So while we can achieve price stability with low growth or high growth, we have limited ability to shift to a high-growth economy.

Mr. PITTENGER. President George?

Ms. GEORGE. I would simply say that the Fed's accommodative policies I think have been important to the progress and the recovery.

But I think to see where the economy is at this stage after this many years suggests that there are other economic policies that should be considered and come to bear on further progress that the economy needs.

Mr. PITTENGER. And could you elaborate on that, just specifically?

Ms. GEORGE. So, for example, I absolutely agree with Dr. Spriggs. It will be important in the United States that any individual that is willing and wants to work is able to find a job.

A healthy labor market will be important, but we must address issues that were raised earlier about businesses that aren't able to find the kind of workers they need, whether that comes from training, education, and other things.

We should seriously look at all policies at our disposal to make sure that that workforce can continue to contribute to the economy.

Mr. PITTENGER. Mr. Jones?

Mr. JONES. I would just elaborate on what President George said.

The single biggest issues I hear from our clients is the inability to attract workers. I think, as Dr. Spriggs said, workforce development is critical. Full employment needs to go beyond what we normally realize full employment to be, and to do that, we need to have more workforce development and training programs to assist with the growth.

Mr. PITTENGER. I would like to ask you as well, do you agree that the Federal Reserve district presidents brings important regional and local knowledge to the FOMC deliberations?

Mr. JONES. I absolutely do. As sitting 6 years in St. Louis and speaking for southern Indiana and western Kentucky, and listening to the voices from agriculture to community leaders to, as I said, the head of Toyota, I can tell you Dr. Bullard and his team took those input very seriously and passed it on. I think it is critical.

We represent diversity. I understand the need for more diverse in terms of race and all, but we represent a diverse economy. And I have clients who sell on the corner of Main and High, and I have Toyota as a client. Those voices are all critical to the process.

Mr. PITTENGER. President Lacker, do you agree with that?

Mr. LACKER. Yes, I do.

Mr. PITTINGER. Thank you. My time has expired. Thank you very much.

Mr. SPRIGGS. Excuse me, Mr. Chair. I apologize. I do need to leave, and I am sorry that I won't be able to stay for the second round of questioning.

Chairman HUIZENGA. Yes.

Mr. SPRIGGS. But I do appreciate you extending me the invitation, and thank the ranking member, as well, for the invitation. And I apologize.

Chairman HUIZENGA. Not a problem. And we appreciate you, Dr. Spriggs, sharing some time with us here today.

We are hoping to do a quick second round, but first we still have a first-round questioner here, the gentleman from Indiana, Mr. Stutzman, who is recognized for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman. And I apologize for being a little late. I just came from a Budget Committee meeting.

But it is good to see Mr. Jones, a fellow Hoosier, and would like to ask Mr. Jones a question.

But first I would like to address President George. In a recent article you observed how Carter Glass, the House sponsor of the Federal Reserve Act and the legislations key author, explained the challenges of establishing the Federal Reserve System in a report to the 63rd Congress. Your article quotes Congressman Glass' observation that, "In the United States, with its immense area, numerous natural divisions, still more competing divisions, and abundant outlets to foreign countries, there is no argument either of banking theory or expediency which dictates the creation of a single central banking institution, no matter how skillfully managed, how carefully controlled, or how patriotically conducted."

My question is this: Are observations like those of the Democratic leader Carter Glass—does the decentralization nature of our Federal Reserve System bring with it a considerable level of integrity under which we can conduct the most basic economic policies—monetary policy? Could you address—

Ms. GEORGE. So I think from the start these issues were debated a long time in coming to the conclusion that a decentralized structure would best serve the country. I think that remains true today.

And I think its value comes from drawing from many parts of the country—not just Washington, not just New York—in bringing those views to bear on something that is very important to the lives of every American, and that are decisions about money.

Mr. STUTZMAN. I think that Mr. Jones can probably attest to this, what is going on in Indiana, because I see this frequently. I mean, I believe that our economy—it is pent up right now, and that it is ready to go but it needs certainty and it needs to know the rules. And if we don't get our monetary policy right, can our economy grow?

Ms. GEORGE. So as I said earlier, I think monetary policy has played an important role, but it is not the only factor in what can stimulate an economy. And as I listen to voices in my region there are questions about other kinds of economic policies that come to bear on their decisions. So I would not want to overburden mone-

tary policy as being the answer to all the issues that can be affecting our economy's performance today.

Mr. STUTZMAN. Sure. And I agree with that, but we are focusing specifically here on decentralization or centralization. Again, sound monetary policy is really a foundation for an economy that is going to be strong.

Mr. Jones, it is great to see you, and I know that your work in Indiana has been recognized not only in Indiana but across the country.

Could you talk just a little bit—just for the benefit, I guess, of others. But in Indiana we have seen—Indiana is pretty strong. The economy is strong in Indiana.

Can you talk maybe a little bit about the differences between some of the state regulation that is encouraging growth, but also I feel like there is this conflict with Washington policy where they are kind of butting heads against each other? And I think not only could Indiana be doing better, but the country as a whole could be doing better. Would you be willing to touch on that?

Mr. JONES. I would.

First, thank you for your service to Indiana, as well.

I mentioned earlier workforce development is a critical issue we hear from our clients. The other issue we hear, and often, is regulation. And it is both current and pending regulation that is challenging businesses to know the roadmap to success.

And you think about coal, which is critical to our state; you think about agriculture and some the changes in agriculture—and clearly, Congressman, you know that as well as anyone. But businesses need a clear path to success, and part of that is understand the regulatory environment they operate in.

Access to capital is a critical element to all of our customers and our clients. So you think about just banking regulation—and I will make an observation—and you have seen Flat Tony. I spoke to our head of compliance yesterday, and getting ready for our first CFPB exam, which is going to be—is very, very important—we submitted 7.5 feet of paper. If you stack it from the ground up it is 7.5 feet.

My head of compliance is five-foot-nine. I am sure there is a lot of good information in there, but it requires a lot of people to review who could be out giving access to capital.

We are symbolic of other industries as well, whether it be coal, agriculture, manufacturing; regulation is a real challenge for clients.

Mr. STUTZMAN. Mr. Chairman, I saw Flat Tony and he was about my height when I first visited him, but now he is much, much taller. It is unbelievable to see the amount of regulation that our institutions have to deal with, so—not only flat but he is tall now.

Chairman HUIZENGA. All right. With that the gentleman's time has expired.

We would like to quickly move into a brief round two of some questioning, if that is all right with our witnesses? And I will start by yielding myself 5 minutes.

And, Mr. Jones, while you were chatting a little bit this struck me as we were talking about your business and what you do. Obviously we have had conversation, not just here but other places,

that the Federal Reserve System is lacking diversity and not doing enough to serve their communities.

I used to be a licensed realtor when I got out of school. And as I said, my family has been in construction and those kinds of things. And one of the fundamental cornerstones of my licensure as a realtor was to recognize that people aren't black, people aren't white, people aren't yellow, people aren't brown, people aren't red, people aren't any color other than green—meaning they can either afford it or they can't afford it.

And that is how you had to treat customers. And that is how you had to deal with people. And it was an equitable way of looking at that.

And it seems to me that there is a similar translation, that we need to make sure that there is an equal opportunity. And what I am really concerned about—and I just saw our friends—our FYDP friends just left, unfortunately. I would have loved for them to hear this.

My goal is to make sure that we have an equality of opportunity for everybody no matter where they live, no matter what their income is. And we have seen time and time again that being thwarted, sometimes for maybe a good goal, but certainly the ways that it has gone about hasn't gotten it there.

And I noticed in your testimony that your organization is remarkably diverse and heavily involved in various communities. And I know that you have a business to run, as well, as part of that.

And so my question is, do feel a conflict between, say, reaching out to literally tens of thousands of people? I know you did—I think it was 900-plus sort of seminars on how to better manage financial affairs on one hand and making money and having an ongoing business with employees and for your investors on the other hand. Do you feel any conflict in that?

Mr. JONES. Not at all. Just the opposite. It is good business.

If you think about what we do as community bankers, our moral obligation is to strengthen our communities. And that means dealing from the underbanked and unbanked all away up to the large corporations.

In doing so, we strengthen the markets that we serve. And there is no real conflict there because that is what a community banker does every day. There is 8,000 of us throughout the country that every day wake up and worry about what we can do to make this a better place for everyone. And those are the voices that we also bring to the Fed as we think about what we do as members of the Federal Reserve Board is to talk about all those voices.

So clearly, Mr. Chairman, there is no conflict. It is just good business.

Chairman HUIZENGA. And what I am very concerned about—because I, too, like one of my colleagues, I can't remember who it was—as they sit down and talk to employers a couple of things that they expressed is they said, “We have a hard time finding somebody who will show up every day be able to pass a drug test.”

Those are those are two basic thresholds that they need to meet. And they say, you know what, we will take care of so much of the

rest of it. We need to have people who will show up, and who can show up clean, and who are willing to work.

And that is a struggle that we have had in Michigan. And I saw a chart earlier today, Michigan is doing different or better than other States in the region of Chicago.

Interestingly enough, Illinois is the lowest performing and Michigan is the highest performing. I would say that it is not just about regulation and taxation; it is about the environment that has been created in. And we in Michigan know that we have very much attempted to create a accommodative, growth-oriented atmosphere, and Illinois has gone the opposite direction. That is why you see billBoards at that at the intersection of Illinois and Indiana saying, "Welcome. We are in Michigan."

Mr. JONES. "Illinnoyed" is what it says. "Move across the border."

Mr. Chairman, I would just say you just took the Hoosier handbook and just took it to Michigan. So it is—

Chairman HUIZENGA. Yes. We did, because Indiana tried that on us for a number of years with those welcome home billBoards. But we—

Mr. JONES. It worked for a while, too.

Chairman HUIZENGA. It did work for a while. We got that turned around.

But I want to make sure that we are moving forward on this, we are not losing sight of Main Street. And Wall Street is doing just fine.

We have to make sure that this economic recovery, as slow and as long and as sluggish as it has been, reaches down and goes to all levels. And we are seeing that. Because of that upward pressure we are seeing wages come up in Michigan. We are seeing some of that—some of those things restored, but not fast enough.

Mr. JONES. Right.

Chairman HUIZENGA. And ultimately that is about demand.

I filibustered myself. My time is up. I was going to ask a quick question of the—of our bankers, but I appreciate your time.

And with that, I will recognize the ranking member for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman.

And thank you all for agreeing to stick around for a little bit longer.

And I, too, Mr. Chairman, am sorry that Mr.—Dr. Spriggs left and some of the other folks who were observing left.

But having said that, I do want to engage the panel on some things that I heard Dr. Spriggs say, and he got a lot of pushback for this in the context of other things that I have heard here today.

There has been a—we have put a lot of pressure on the Fed to grow our economy. There is a lot of criticism or praise on both sides of the aisle regarding your fixes—what you have done.

But that being said—I am—I think it was Mr. Jones that said that you guys have a blunt instrument with monetary policy. I think it was Dr. Lacker responding to the gentlelady from Utah, saying that monetary policy has to fit for the whole country. We can't have a monetary policy for New York and then another one for Montana. So you are limited in terms of what you can do.

That being said, I guess I am wondering what you think about the slow growth, the lack of a recovery in certain parts of the country among folks like African-Americans with regard to what, number one, what Congress is doing?

We focus a lot on austerity and we believe that that has hurt growth. For example, there is a gap of \$1.7 trillion in infrastructure spending, something that used to be bipartisan, and it is predicting that could put 20 million people to work if we were to do that versus giving tax cuts.

And so I guess I am wondering—and Dr. Spriggs said that there is a lack of demand. So as we talk about regulation being too great, the debt being too great—he made the point that 70 percent of our economy depends of people having money so they can spend it.

I know in the African-American community they spend every dime that they get. So if shops are closing down an African-American communities it is because they don't have any money.

So I am wondering what you all think about what we do with regard to hurting growth this country. What is your opinion on sequester, and austerity, and cutting Pell Grants, and so on?

And I will yield to maybe Dr. Lacker?

Mr. LACKER. You have asked a difficult and troubling set of questions. You asked me to stray outside of the bounds of Federal Reserve policy.

I can tell you, though, that we do think about that and it is hard not to in our country. Baltimore, for example—inner-city Baltimore is part of my district—and in thinking about the events that have transpired there in the last couple of years it is hard not to think about why it is that African-American communities have lagged so far behind despite the last 50 years of efforts, despite the vast array of interventions we have made, despite the vast array of policy initiatives that have brought to bear on that.

Dr. Spriggs is right that Federal Reserve policy can influence the broad sweep of demand in our country. But there is nothing we can do to guarantee where it is going to show up.

Is it going to show up in Silicon Valley? Is it going to show up in the Carolinas? Is it going to show up in inner-city Baltimore?

Ms. MOORE. Just specifically, though, is the time to be doing austerity with slow growth?

Mr. LACKER. I would think you would want to evaluate programs on their merits, not for what they add to total aggregate demand.

Ms. MOORE. Okay, just, a transportation bill or infrastructure bill that was adequate—do you think that that would help your efforts to—

Mr. LACKER. I think you should evaluate a transportation bill based on what our transportation infrastructure needs, not on whether it adds—

Ms. MOORE. I think we have like 80,000 bridges that could collapse just like in Minnesota at any point.

Mr. LACKER. That is a legitimate—

Ms. MOORE. It is not like we don't need—we don't have to go out and do a survey to see if we need to fix the roads and bridges.

Mr. LACKER. That sounds like a legitimate reason. I have no reason to disagree with it.

Ms. MOORE. Would that or would that not spur our economy, Mr. Jones? You are chomping at the bit.

Mr. JONES. Well, chomping at the bit is a strong thing.

But clearly, creating jobs, creating demand will help all of our markets. And the economy is just not one subsection; the economy is a multitude of policies and procedures and inputs.

One of the biggest one we see his confidence. And if we could get a consistent message that said, "It is okay," then I think you will see more and more people respond to the economy. But it is awfully difficult when all the negativity that surrounds our economy creates challenges.

Ms. MOORE. Thank you.

I yield back. Thank you for your indulgences, Mr. Chairman.

Chairman HUIZENGA. You are welcome.

With that, the Chair recognizes the gentleman from Arizona, Mr. Schweikert, for—

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

And to my friend the ranking member, we partially agree here but it is—like on infrastructure, if the left would be willing to work with some of those who want to stack—adjust the capital stack and how you pay for it, there is a way to get there.

As the discussion we had earlier with Mr. Stutzman, when you have seven feet tall of regulatory paperwork for a bank examination, how does that improve productivity in our society? Because functionally you have paperwork, it goes into file cabinets. So that is what they said earlier. That was the testimony just about 20 minutes ago.

So for many of us we are fixated that we believe monetary policy probably has gone as far as it can and now it is our responsibility here, but we need to get creative, instead of just trying to do more of we are going to throw a bunch of cash at something. We see how well that crashed and burned in 2010 and 2011, the years where we—all these models said this was going to happen and it didn't.

So can I go off—this is just a different discussion. But, Ms. George, you are someone I wanted to sort of ask because—walk me through first the services your Federal Reserve branch provides. Just sort of, from someone who was on one of the old check 21 committees and those things many years ago—yes, I am that old. Walk me through the services you provide.

Ms. GEORGE. So the regional banks are involved in the payment system, and we still have—

Mr. SCHWEIKERT. So payment—ACH?

Ms. GEORGE. ACH. We are still clearing checks, believe it or not. We distribute cash to financial institutions in our region, and we are involved now in an effort to look at how to modernize the payment system by working with the private sector on how that might happen.

Mr. SCHWEIKERT. Okay. So you already know where I am going.

I see now, fascinating discussions coming out of Silicon Valley of using a distributive ledger model to basically—it is a functioning debit-credit ledger with sort of an airtight mechanics to move money and dramatically cut down the costs. Where if I am—let's use PayPal just because they are in my neighborhood or a substantial portion of them are—they have landed—what—a Utah indus-

trial Bank to move money. They pick up those regulatory costs, where if I use a block chain, put it into a cryptic currency or whatever you want, some designation of value and clear it on this side, all of a sudden I have moved money for fractions of a penny. But that is outside your mechanics.

From your discussion—because you have lots of really smart people around you—are you ready for what you and I would call the creative destruction that will help us bring dramatically more efficiencies in the movement of money, the distribution of those resources? And are you looking at these alternative transmission networks and how to lower the cost?

Ms. GEORGE. So our responsibilities in this area are to make sure that the payment system is efficient, that it is accessible, and that it is safe.

And so the nature of this technology holds some interesting promises, and as part of our work with the private sector to think about how this will affect the payment system going forward, we are very much engaged in learning from them and trying to see where this intersects.

Mr. SCHWEIKERT. But you already know—we already have a handful of our large money center institutions—two of them—that are actually already engaging in the movement of money using a distributive ledger.

Ms. GEORGE. Yes.

Mr. SCHWEIKERT. And why this is so important is for a lot of us who really care about economic vitality, but also optionality for things like millennials, is you are the Uber driver, and you decide you are going to put \$0.50 into your retirement account or into your savings account every time you drive someone, and you hit—we just do a smart contract in the back so the payment hits, the \$0.50 goes over.

Except on some of the networks that just cost \$.18, \$0.27 to move that \$0.50. You cannot do the sort of micromanagement of small dollars.

I need a network, a—I need a backbone that is dramatically less expensive—safe because this is soon going to be our banking institution.

And my great fear is, as we have had the conversation of efficiencies in our society, productivity—I desperately hope that the Federal Reserve doesn't become one of the barriers to the adoption of the dramatically more efficient society that we desperately need for that productivity.

And my fear is Silicon Valley is about to run around you and build optionality that says the Federal Reserve is my barrier not my partner.

And with that, I am out of time. Thank you, Mr. Chairman.

Chairman HUIZENGA. Thank you.

And for our last question of the day we will go back to the gentleman from Indiana, Mr. Stutzman, for 5 minutes.

Mr. STUTZMAN. Thanks again, Mr. Chairman.

And thank you to all for your testimony and thoughts and advice today. It is really helpful. This is a—it has been a fascinating discussion and I—Ms. George, you made a comment about disturbing cash and things like that and then, of course, Mr. Schweikert holds

up his smart phone. And I guess that is where I wanted to go, and I think it kind of falls under maybe governance? And maybe you could just—all of you could share with us—online banking, security, access?

I just found products just recently that are extremely easy and almost feel like they are—they are very easy, which is nice, but the security of them—can we trust the technology that is coming along?

And I know this has—I don't know if it has been talked about at all today, but if some of you could kind of address that and what is your role? And then, Mr. Jones, if you could talk—maybe you could lead off, Mr. Jones, about what you all are doing is a banking institution in online banking and how much of it is being done on smart phones?

Websites are being adapted to fit smart phones because that is where most of the banking is being done. If you talk that; then, Ms. George and Dr. Lacker, if you could talk about what the Fed's role is in all that?

Mr. JONES. Sure.

Great question. And clearly as you think about our industry and the dramatic changes, fintech and mobile banking are going to be at the forefront over the next few years, if not already.

Your question really revolves around cybersecurity. And I would offer, as a commercial banker, this is an area where great cooperation between our regulatory agencies and the commercial banks has made a significant difference.

Both the Federal Reserve, and the OCC, and now the CFPB have come together, and we are working to make sure that those systems are safe and secure.

Richmond, where Dr. Lacker is, is the head of I.T. for the Federal Reserve. And when I was the audit Chair in St. Louis we were able to experience the great controls they have in place. So take that knowledge of the commercial banks—8,000 commercial banks can't work separately on things like cybersecurity. It takes a collaborative approach.

And again, as I said, the ability for the Fed to convene commercial banks—the OCC the CFPB—to really combat that has made a significant difference. And it has made large, significant improvements for us.

Ms. GEORGE. So there are rapid changes going on in our payment system, as you note.

And the initiatives that we currently have underway is to carry on a tradition we have had for most of our history, and that is to work with the private sector as they come up with different ways to conduct payments to make sure at the end of the day safety, accessibility, and efficiency is part of that.

And so the effort we have undertaken right now is in the process of looking at those issues around new technologies to see how that can be best managed on behalf of the public.

Mr. LACKER. We do, as Mr. Jones noted, invest a tremendous amount of the Federal Reserve System to a secure our systems to make sure they are safe and effective, but that we keep up with the latest cybersecurity threats. And cooperation from agencies based around here in D.C. have been very important to that.

For the banking system as a whole, we cooperate with sharing what we know and can share. And it certainly led us to focus on the extent to which the cyber risks are being managed effectively in the banking sector, as well. So it is a supervisory focus for the teams that oversee these large organizations and small, as well.

So it is something we take seriously. It is an evolving landscape, and so it is one where we are going to have to continually keep keeping up, in essence.

Mr. STUTZMAN. How do you do that? Do you hire teams of experts who know their industry that are on your side that are working together but also making sure that there are safeguards in place? Do you have to invest more down the road or are you already making an initial investment focusing on banking?

Mr. LACKER. Our investments have increased substantially over the last 10 years in information security. And yes, talent is something we look at. The particular skill sets you need are highly valuable in the marketplace and we work very hard to find the skills that we need.

Mr. STUTZMAN. Thank you, thank you. Anybody—I don't know—any further comments? There is 20 seconds left if anybody wants to say anything.

If not, I will yield back to the chairman.

Chairman HUIZENGA. Gentleman yields back.

And I would like to thank our witnesses for taking the time and coming. Deeply, deeply appreciated by all of us. I think I have had a number of colleagues as they have been going giving me thumbs up. And we thought this was a very informative, very helpful hearing as we are looking at what the future of this monetary system is and the effects of it.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

I ask the witnesses to please respond as promptly as you are able.

And that with that, our hearing is adjourned.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

A P P E N D I X

September 7, 2016

Statement of
Esther L. George
President
Federal Reserve Bank of Kansas City
before the
House Subcommittee on Monetary Policy and Trade
United States House of Representatives

Sept. 7, 2016

The views expressed by the author are her own and do not necessarily reflect those of the Federal Reserve System, its governors, officers or representatives.

Chairman Huizenga, Ranking Member Moore and members of the subcommittee, thank you for this opportunity to share my views on the role of regional Federal Reserve Banks as part of the Federal Reserve System.

Because the Federal Reserve is an institution that makes decisions of consequence to the broad public, a discussion of these matters is worthwhile. If changes are to be considered, the public should understand not only the Congressional intent for its current design, but also the strong safeguards that assure its accountability.

Central banks are unique institutions. They have important responsibilities for a nation's financial system and economy. Congress, as it contemplated a central bank for the United States more than 100 years ago, took note of central bank models from other countries, while keeping in mind two earlier attempts at central banking in the United States. Ultimately, it opted for a different approach: one that recognized the public's distrust of concentrated power and greater confidence in decentralized institutions. The Federal Reserve's unique public/private structure reflects these strongly-held views and is designed to provide a system of checks and balances. Challenges to this public/private design have surfaced throughout the Federal Reserve's history, not unlike they have today. But in the end, our country has remained most confident in this decentralized governance structure.

Criticism of the quasi-private nature of the regional Reserve Banks was anticipated from the start. Indeed, the Federal Reserve Act leaves no unchecked power in Reserve Banks. The politically-appointed members of the Board of Governors have oversight authority of the most important governance aspects of Reserve Banks. For example, they appoint the Chair and Deputy Chair of a Reserve Bank's board; they vote to approve the selection of the Bank's president as well as its chief operating officer; and they approve the Reserve Bank's budget and

salaries. The Board of Governors also meets with each Bank's Chair and Deputy Chair annually to review the Bank's performance and that of its president. Finally, the Reserve Bank's operations are reviewed by the Board of Governors and an outside independent auditor.

Notwithstanding this strong public oversight, some question the role of commercial banks within the Fed structure. Here too, important safeguards exist. The supervision and regulation of the Federal Reserve's member banks is a statutory responsibility of the Congressionally-confirmed Board of Governors. Bankers who serve on Reserve Bank boards are prohibited by law from participating in the selection of the Bank president, and no director can participate in bank supervisory matters. Finally, all directors are required to adhere to high ethical standards of conduct and avoid actions that might impair the effectiveness of the Federal Reserve's operations or in any way discredit the reputation of the System.

The capital stock supplied by these member banks serves as the foundation for the decentralized structure allowing for separate corporate entities. Through the regional Reserve Banks, private citizens from diverse backgrounds and from the largest to the smallest communities, have input into national economic policy; strong and varied independent perspectives more easily emerge to engage in difficult monetary policy discussions; and the central bank is provided insulation from short-term political pressures.

Altering this public/private structure in favor of a fully public construct diminishes these defining characteristics in my view. It also risks putting more distance between Main Street and the nation's central bank.

Former Fed Chairman Paul Volcker understood this well. He experienced first-hand how public pressure can be exerted on a central bank when it must make unpopular decisions that he and the FOMC judged to be in the long-run best interest of the economy. In a 1984 speech, he

noted the important role of the structure of the Federal Reserve System in supporting the central bank's decision making by saying, "It was all quite deliberately done by men of political imagination -- designed to assure a certain independence of judgment, a continuity and professionalism in staff, a close contact with economic developments and opinion throughout our great land and a large degree of insulation from partisan or passing political concerns."¹

To that end, I extend a personal invitation for any of you to visit the Federal Reserve Bank of Kansas City to see what a regional Federal Reserve Bank provides in support of the central bank's objectives for economic stability. Thank you. I look forward to taking your questions.

¹ Paul A. Volcker, "Remarks at the 78th Commencement of the American University," (speech, Washington, D.C., Jan. 29, 1984), https://fraser.stlouisfed.org/docs/historical/volcker/Volcker_19840129.pdf

**STRUCTURE, GOVERNANCE, REPRESENTATION:
Federal Reserve Member Banks and Federal Reserve Bank Stock**

Esther L. George
President and Chief Executive Officer
Federal Reserve Bank of Kansas City

July 2016

INTRODUCTION

The Fixing America's Surface Transportation (FAST) Act changed the Federal Reserve Bank stock dividend rate for member banks with assets of more than \$10 billion. The Act also placed a cap of \$10 billion on the aggregate surplus funds of the Federal Reserve and directed that any excess be transferred to the Treasury general fund. The potential policy implications of modifying dividends to member banks, or more generally, the requirement for member banks to purchase stock in a regional Federal Reserve Bank, should be studied carefully before altering this long-standing institutional design of public and private interests serving the American public.

In designing the governance structure more than a century ago, Congress accepted a compromise proposal from President Woodrow Wilson to create a central bank with a combined public and private structure with those roles filled respectively by the Board of Governors of the Federal Reserve System and the regional Reserve Banks. In this design, the stock ownership of the regional Reserve banks is a key component in a central bank design that provides representation for both the public and private interests with each acting as a potential limit on the control of the other.

The debate regarding the role of Federal Reserve stock in the Federal Reserve System structure is not a new one: In 1938, Congressman Wright Patman proposed that the government should take over the Reserve Bank stock, effectively turning the regional Reserve Banks into full government entities. At the heart of this issue is whether changes that aim to alter the private/public status of the central bank and potentially nationalize the 12 regional Federal Reserve Banks could undermine the barriers carefully constructed by Congress to protect against political pressures on Federal Reserve policies.

This analysis offers historical perspective on these issues, as well as an assessment of the effectiveness of the current governance and structure of the Federal Reserve System.

A LOOK BACK ON CENTRAL BANKING IN THE UNITED STATES

A careful reading of Federal Reserve history will find that proposals for increased government authority over the Federal Reserve are often raised most pointedly during periods when government debt is high. Pressure on the Federal Reserve to implement policy supportive of government spending dates back almost to the 1913 founding of the Federal Reserve and the subservient role the Federal Reserve soon assumed related to government financing demands in connection with World War I. Similar pressure continued during and after World War II.

Eventually, the Federal Reserve's resistance to continually supporting government spending led to a formal accord with the Treasury in 1951.

The list of events that have occurred in these environments is long and includes such high-profile instances as pressure from President Lyndon Johnson to hold rates low as a means of supporting his proposals during the Vietnam War to calls for Federal Reserve Chairman Paul Volcker's resignation during the Federal Reserve System's successful, but painful, battle against high inflation. Beyond these major events, numerous legislative initiatives have met varying degrees of success over the years but have overall led to what Duke University economics professor Thomas Havrilesky termed the "deterioration of traditional constraints on the political manipulation of monetary policy" since the modern Federal Open Market Committee (FOMC) was created in 1935.²

The Failure of Earlier Central Bank Designs

At the time of the Federal Reserve's founding, the United States had already witnessed two unsuccessful attempts at establishing a central bank. Neither was able to outlast their initial 20-year charter.

There was intense political debate around the creation of both the First Bank of the United States, in 1791, and its successor, the Second Bank of the United States, in 1816. While recognizing the need for the stability that a central bank could provide, many Americans with vivid memories of the fight to win independence from England were understandably leery of creating another powerful institution. As a result, both the First and Second Banks were the focus of significant public distrust. Both were highly centralized institutions that many Americans viewed as too closely aligned with powerful political and financial interests of the Northeast. In the early 1900s, after a series of financial crises, a third effort was launched to create a central bank with a structure that combined both government and private interests.

Carter Glass, the House sponsor of the Federal Reserve Act and the legislation's key author, explained the challenges in a report to the 63rd Congress:

"In the United States, with its immense area, numerous natural divisions, still more competing divisions, and abundant outlets to foreign countries, there is no argument either of banking theory or expediency which dictates the creation of a single central banking institution, no matter how skillfully managed, how carefully controlled or how patriotically conducted."

As Glass's comment suggests, the concern about centralization was not something that could be addressed solely by geography or the number of bank facilities. Nor was it simply a question about adjusting the bank's ownership structure. While both of those are elements of a decentralized structure, arguably the most important issue—and the glaring weakness of both the First and Second Bank—was the centralization, or the perceived centralization, of control.

Indeed, both the First and Second Banks were geographically diverse with branch offices located in the important financial centers of their eras. Additionally, both had a combined public/private ownership; however, the ownership structure utilized in each case was problematic for two key reasons: the need for profits, and the homogeneity of ownership and centralization of control.

² T. Havrilesky, "The Politicization of Monetary Policy: The Vice Chairman as the Administration's Point Man," *Cato Journal*, Vol. 13, No. 1 (Spring/Summer 1993). Copyright Cato Institute.

- The Risks of a Structure that Requires Profits

Although the nation's first two central banks had slight differences, particularly in their size, they were alike in many key structural ways. In both cases, private investors held an 80 percent ownership stake while the government held the remaining 20 percent. Investors acquired their shares through an initial public offering (IPO) process that was similar to other public stock offerings. In the case of both banks, the IPO involved the immediate sale of subscriptions, or "scrips," that were essentially a down payment for a later stock purchase. Scrip and stock purchases for the First Bank, which required the combined use of specie (gold or silver) and U.S. debt securities to complete the transaction, created what is now considered the nation's first financial crisis when scrip prices soared on high demand, causing debt markets to become distorted. While this distortion and the resulting U.S. financial crisis was an early indication of one of the many potential risks in a profit-seeking central bank structure, the era's more prominent international example involved the privately-held French central bank, Banque de France, which took actions in the 1880s to protect and increase profits—moves that had a negative impact on its effectiveness as a central bank.

- The Consequences of a Homogeneous Leadership Structure

Shares for both the First and Second Banks were prohibitively expensive for most Americans. Stock in the First Bank, for example, was initially offered at \$400 per share (the equivalent of about \$10,000 in 2016 after accounting for inflation). Stock in the Second Bank was still pricey at about a quarter of that cost. As a result, U.S. central bank ownership was vested primarily in the hands of wealthy and powerful individuals (including—perhaps unexpectedly—a number of foreign investors). Similarly, the majority of the directors of the First and Second Banks were elected from the ranks of the politically and financially powerful, including some members of Congress, who lived in and did business in the nation's power centers. The lack of diversity of central bank leadership was a major criticism, especially from those living outside of the East Coast.

The Combination of Public and Private Components: Checks and Balances

Economic historians sometimes note that the fundamental issue about a U.S. central bank correlates with the fundamental issue dividing America's two chief political ideologies: the role of government versus the role of the private sector.

At the time of the Federal Reserve's founding, most of the world's other central banks were privately held institutions. In the United States, the Federal Reserve's congressional creators recognized that a private structure would not work and instead devised a structure with checks and balances between the private sector and the government.³

Balancing government authority over the central bank was not solely about placating political ideologies that preferred limited government. The primary motivation was to avoid the use of monetary policy and inflation as the means of financing government debt. Related to this concern, of course, was the risk of Federal Reserve policy manipulation for political gain.

³ T. Todd, *The Balance of Power: The Political Fight for an Independent Central Bank, 1790-Present*, Federal Reserve Bank of Kansas City, 2009.

To address concerns about national debt funding, the Federal Reserve Act expressly prohibited the direct financing of the Treasury. However, since the Federal Reserve's founding, political pressure to ease monetary policy has surfaced.⁴

To mitigate this political pressure, the Federal Reserve's creators made the Reserve Banks private entities under the supervision and control of a board of directors with authority to perform all duties usually pertaining to directors of a banking association. This includes the appointment of the president and first vice president (directors affiliated with supervised entities are no longer involved in this process), appointment of officers, prescribing by-laws, and designating a representative for the FOMC. As initially designed, the Reserve Banks were far more autonomous than they are today. While the Federal Reserve System's government component has always been responsible for Reserve Bank oversight, the Federal Reserve's key functions, including monetary policy, were under the purview of the Reserve Banks during the System's early history. Over time, the monetary policy function has become balanced between the private and public components with the Board of Governors holding the majority votes. The FOMC consists of 12 members: seven members of the Board of Governors and five Reserve Bank presidents.

Private Sector Involvement

While private sector involvement through a network of separate and distinct Reserve Banks located across the country expanded leadership diversity and helped balance government authority, on the surface it presented another problem: how to engage the private sector while preventing risks associated with a pure-profit motivation. This aspect was addressed by putting restrictions on Reserve Bank stock and establishing the Board of Governors' authority for oversight of the Reserve Banks.

While law requires stock ownership in Federal Reserve Banks as a condition of a commercial bank's membership in the Federal Reserve System, this stock is not like stock available on public markets. It may not be sold, traded or pledged as security for a loan. It does pay a dividend rate that is established by statute and, as a result, cannot be manipulated through the use of Federal Reserve policy tools or otherwise. This design provides the Federal Reserve System with private ownership over the Reserve Banks, but without the profit motivation that can distort policy.

Stock ownership allows member banks to nominate and elect Class A and B directors to a Reserve Bank's Board of Directors. However, unlike traditional corporations which grant one vote per share, the Federal Reserve Act provides for class voting wherein each member bank receives one vote as a member of one of three designated classes based on the total amount of capital, surplus and retained earnings of the member bank. There are further limitations on voting as each class elects only one Class A and one Class B director.

In addition to these restrictions on Reserve Bank stock, the Board of Governors plays an important oversight role, including its authority to:

- Examine at its discretion the accounts, books and affairs of each Reserve Bank;
- Suspend or remove any officer or director of a Reserve Bank;
- Order an annual independent audit of the financial statements of each Reserve Bank;

⁴ T. Todd, *Under Pressure: Politics and The Federal Reserve During the 1990-1991 Recession*, Federal Reserve Bank of Kansas City, 2011.

- Approve compensation provided by Reserve Banks to directors, officers, and employees;
- Approve the president and first vice president appointed by the Reserve Bank Class B and C directors; and
- Appoint three of the nine Reserve Bank directors, including the Reserve Bank's chair and deputy chair.

MEMBER BANKS HELP RESERVE BANKS FULFILL THEIR MISSION

Stockholders of the Federal Reserve System, also referred to as members, have some rights and obligations similar to traditional corporate stockholders in that they provide capital to the Federal Reserve Banks, which are federally-chartered corporations. All national banks along with state-chartered banks that choose the Federal Reserve as the bank's primary federal regulator are required to purchase Federal Reserve stock. By purchasing stock, members are entitled to a dividend fixed by statute as well as a role in Reserve Bank governance.⁵ Members are therefore invested in the Reserve Banks' and Federal Reserve System's success and are integral to the Federal Reserve's mission. Member banks must buy stock in the Federal Reserve Bank equal to 6 percent of the bank's capital, 3 percent of which is held at the regional Reserve Banks. The other 3 percent is callable by the Bank in certain circumstances. Paid-in capital from member banks was the initial funding mechanism for the Federal Reserve Banks, and the 3 percent on call remains available in the event it is needed by the Reserve Banks.

Role of Member Banks in Governance of Reserve Bank Activities

Stockholding member banks elect a portion of the Reserve Banks' director seats,⁶ are core to Reserve Bank corporate governance and provide critical industry information and

⁵ The dividend rate was set to 6 percent in the original 1913 Federal Reserve Act to provide a rate of return comparable to alternative risky investments and to attract state-chartered banks as members. Investing in the Federal Reserve in 1913 was not risk-free given that the previous two central banks in the United States had not survived and the short-term ability to pay a steady dividend was unclear. Today, however, Federal Reserve stock is essentially a risk-free perpetual bond as long as a bank chooses to remain a member. While the dividend remained unchanged for over a century, analysis by the Bipartisan Policy Center found it was similar to the average return on the 10-year U.S. Treasury note over that period (A. Klein, K. Readling, O. Weiss, A. Woff; "Federal Reserve Dividends Should Not Be a Piggy Bank for Congress," Bipartisan Policy Center, 2015). The Fixing America's Surface Transportation Act, 129 Stat. 1312 ("FAST Act"), effective Jan. 1, 2016, changed the dividend for stockholder banks with more than \$10 billion in total consolidated assets from a fixed 6 percent rate to a dividend equal to the lesser of 6 percent or the rate equal to the high yield of the 10-year Treasury note auctioned at the last auction held prior to the payment of the dividend. The 10-year Treasury bond rate is seen by some as a reasonable alternative because it is the benchmark risk-free rate used for most long-term, fixed-rate investments and has a long history of continual issuance. The 30-year Treasury rate might also be an option because it is the longest maturity Treasury rate, but there is a risk that the Treasury could decide to stop issuing it at some point as it did from late 2001 to early 2006.

If a market rate is used as a reference rate, it should not be capped at 6 percent as it currently is for member banks with more than \$10 billion in assets. Using a market rate only when it is below a threshold is economically inconsistent with the notion of tying returns to the market, and it is inequitable to penalize member banks when rates rise above the threshold. In addition, changing the dividend has raised questions about the appearance of breaking an agreement with members. The American Bankers Association asserts that the FAST Act's dividend rate change amounts to an unconstitutional taking of member banks' property without compensation. See Letter dated April 28, 2016 from Rob Nichols, president and CEO of the American Bankers Association, to Robert de V. Frierson, secretary, Board of Governors of the Federal Reserve System (Attachment B). An alternative would be to allow current members to retain the 6 percent dividend or elect the 10-year Treasury rate and issue a new class of stock for new members with the dividend tied to the 10-year Treasury rate.

⁶ Class A and B directors are nominated and elected by member banks within their respective Federal Reserve District. Unlike traditional corporations, which grant one vote per share, the Federal Reserve Act provides for class voting wherein each member, regardless of shares, receives one vote as a member of one of three classes. The classes are designated based on the total amount

perspective on economic and banking conditions. At the same time, the structure includes shared oversight with the politically appointed Board of Governors that prevents members from having undue influence on Federal Reserve System activities.

The Federal Reserve Act states that every Reserve Bank “shall be conducted under the supervision and control of a board of directors,” and provides that the nine director positions of the Reserve Bank’s board of directors are filled through two methods: election and appointment (12 U.S.C. 301). Only three of the nine directors on a Reserve Bank’s board may be officers, directors or employees of a bank. Those directors (Class A) are chosen to represent member banks. The remaining six directors (Class B and Class C) cannot be bankers, and are chosen to represent the public with “due but not exclusive regard to agriculture, commerce, industry, services, labor and consumers” (12 U.S.C. 302). While member banks nominate and elect the Class A and Class B directors, this Reserve Bank’s staff plays an important role in considering representation from local and regional organizations to identify qualified candidates. Likewise, Class C directors are identified by Reserve Bank leadership with appointment by the Board of Governors. The chair and vice chair of the Reserve Bank board of directors must be selected from the Board of Governors-appointed Class C directors. Reserve Bank directors come from diverse backgrounds in the region and across industries. They must comply with legal requirements and rules related to their eligibility and conduct.

Benefits of Banker Directors

Reserve Banks are nationally chartered banks that serve as the operating arms of the central bank. They function much like a banker’s bank or a clearing house. As such, banker directors’ knowledge of the payments system complements the Reserve Banks’ operational role in providing financial services to the industry. Indeed, corporate best practices recognize that “the key to effective board composition is ensuring that the people gathered around the board table can leverage their experience to contribute in meaningful ways, to understand the issues, ask the right questions, demand the right information, and make the best possible decisions.”⁷ Class A directors bring informed views related to banking, as well as to the industries of their customers, and act as consolidators of information. For instance, a banker director can provide details about lending trends, stresses in the financial system, and other banking metrics, in addition to sharing insights into farming, commercial real estate, housing and the auto industry. Their reports at Reserve Bank board meetings offer input to economic analysis used by Reserve Bank presidents for monetary policy.

Limitations to Banker Influence

While Reserve Bank directors have important oversight responsibilities for the operation of their respective Reserve Bank, they have no involvement in the Federal Reserve’s supervision of depository institutions. By law, the Board of Governors of the Federal Reserve System is responsible for the supervision and regulation of banks, and any information or discussion related to supervisory issues is conducted directly between a regional Reserve Bank’s staff and the Board of Governors. In addition, any supervisory matter regarding a Class A director’s bank is handled by the Board of Governors.

of capital, surplus and retained earnings of the member bank within the class. Not every class votes each year, and each group within the class elects one Class A and one Class B director.

⁷ D. Nadler, B. Behan, and M. Nadler, *Building Better Boards* (Jossey-Bass 2006).

Reserve Banks may not provide confidential supervisory information to any director (12 C.F.R. 261.2). Moreover, Reserve Bank directors may not participate in bank supervisory matters and may not be consulted regarding bank examination ratings, potential enforcement actions, application/approval matters, or similar supervisory matters. In regard to the Reserve Banks' lending activity involving financial institutions, directors receive only aggregate information about loans extended to ensure adequate knowledge of the Reserve Bank's balance sheet per their oversight responsibilities. Finally, if a banker director wants to convert his or her bank to Federal Reserve membership or take any other actions that would involve Federal Reserve regulatory approval, the Board of Governors in Washington must act on the application without Reserve Bank involvement.

Statutory and Policy Restraints

The directors representing member banks are subject to other restraints by statute and through System policy. As noted above, only Class B and Class C directors appoint, subject to approval by the Board of Governors, the Reserve Bank president and first vice president. Class A directors are excluded from that process to eliminate the perception that they have a role in choosing their regulator. Class A directors also are prohibited from participating in the selection, appointment or compensation of Reserve Bank officers whose primary duties involve supervision of banks for the same reason.

All directors are subject to the Guide to Conduct for Directors of Federal Reserve Banks and Branches (<http://www.federalreserve.gov/generalinfo/listdirectors/PDF/guide-to-conduct.pdf>), a policy implemented to ensure adherence to high ethical standards of conduct, and avoid actions that might impair the effectiveness of Federal Reserve System operations or in any way discredit the reputation of the System. The policy details procedures when directors are involved in procurements as a means to avoid any actual or apparent conflicts of interest. Further, while the policy allows for waivers, it indicates waivers are both highly unlikely and strongly discouraged except under the most exigent and extraordinary circumstances. This Reserve Bank has never sought a waiver for a director.

CONCLUSION

Altering the current structure and character of the Federal Reserve System risks diminishing the effectiveness of its operations.

For more than a century, the structural design of the Federal Reserve System has functioned well in carrying out its mandates from Congress. It is possible that Reserve Banks could operate as separate corporate entities without stock ownership, but altering the central banks' current design creates the potential to diminish its effectiveness.

- The private nature of the Reserve Banks through stock issuance to member banks provides balance to the public nature of the Board of Governors. The public's trust and confidence is enhanced by this "balance of power."
- Requiring stock purchases through capital investment creates incentives for member banks to support successful outcomes for the Reserve Banks.
- Rather than a Washington-centric voice for the Federal Reserve System, the structure of 12 separate Reserve Banks encourages strong and varied perspectives from across the country as the System fulfills its mission.

- The structure of the Reserve Banks as separate corporate entities allows private citizens from communities across the country to have input into national economic policy.
- The current decentralized structure insulates the Federal Reserve System from certain political pressures, as the Reserve Bank presidents are not political appointments, but instead chosen by Class B and Class C directors, with approval by the Board of Governors.

Nationalizing the Reserve Banks, and thereby making them essentially field offices of the Board of Governors, would dramatically alter these defining characteristics.

PUBLIC COMMENTS ON STRUCTURE AND GOVERNANCE

Esther L. George
 President and Chief Executive Officer
 Federal Reserve Bank of Kansas City

THE EXCHEQUER CLUB, WASHINGTON, D.C.

May 21, 2014

An “End the Fed” demonstration took place outside my office last Saturday on Main Street in Kansas City, Missouri. It was a reminder that democracy demands accountability from its most powerful institutions to its citizens. The Federal Reserve is no exception.

In my role as president of a regional Reserve Bank, I am well aware of the range of views on the topic of Federal Reserve accountability. I’d like to share with you some comments I read recently. For example, one commentator wrote that even if the central bank’s “power would remain in the hands of the wisest, the most honorable, and the most disinterested” leaders, “it would not be possible to satisfy the people throughout the country that the vast resources and powers of the bank were used only for the best interests of all the people and without partiality or favor to any section of the country, or to any class or set of people....” When it comes to the nation’s financial matters, someone else noted that authority should not be “concentrated in one city where a small clique could control the system.”

Yet another comment stated that, “The business resources of the United States...cannot be centralized. ...By reason of the great expanse of the country and the diversity of business conditions in the different sections of the country, the details of the business of a central bank could not be managed at a central office.”³ Finally, the desire for local control was highlighted in this comment: “No centralized power could dominate an organism whose life is drawn from functions local to each community.”

The sentiments behind these words—concerns about power and the concentration of financial resources—ring true, but they are not in fact comments on the recent financial crisis. This commentary offers a flavor of the robust and contentious public debate that preceded the signing of the Federal Reserve Act in 1913. It is striking to me how familiar those words are today. It was this public sentiment about the country’s economic future under a central bank that influenced Congress to shape the institution in a way that would garner the trust and confidence of the American public. The result was a decentralized structure that exists today with locations across the country operating under a rigorous system of checks and balances.

As a career Federal Reserve employee, bank supervisor and lifelong Missourian, I understand the importance of having a central bank that is accountable to the public. In fact, as an official with input to national policy who lives and works in the center of the United States, my role is not happenstance, but rather it is a deliberate choice on the part of the Federal Reserve’s congressional founders that reflects their intentions for the structure of the nation’s central bank. It is my view that the Federal Reserve’s ability to achieve its broad objectives over the past century has been possible because of its decentralized structure.

Full speech text:

<https://www.kansascityfed.org/-/media/files/publicat/speeches/2014-george-washington-exchequer-05-21.pdf>

CENTRAL EXCHANGE, KANSAS CITY, MO.

Feb. 2, 2016

... As the Federal Reserve contemplates the appropriate path of normalizing its monetary policy, it naturally does so with considerable public attention. One source of this attention comes from Congress itself. Calls for legislative reforms of the Federal Reserve have persisted over the past five years, ranging from its structure and governance to its monetary policy approach and decision making. Additionally, Congress has shown its willingness to tap the Federal Reserve to fund fiscal activities ranging from new government agencies to highway construction.

I understand that Fed actions during the crisis have raised a number of questions about the institution and its scope. When Congress established the Federal Reserve more than a century ago, it designed the institution to be apolitical but with accountability to Congress. This construct was designed to protect the stewards of the nation's money supply from the vulnerabilities associated with short-term political agendas. It includes important checks and balances that are often misunderstood, but nonetheless critical to the functioning of the institution.

During my 33 years at the Federal Reserve Bank of Kansas City, the primary focus of thousands of dedicated Federal Reserve employees has been the health of the economy, supported by an efficient and accessible banking and payments system. To the extent that there is any doubt in the minds of Congress or the public about this, it is incumbent on the Federal Reserve to work with Congress in a direct and transparent way until we satisfy any remaining questions about the execution of our mission. Such dialogue would provide the highest probability for outcomes that best serve the public interest.

Full speech text:

<https://www.kansascityfed.org/~media/files/publicat/speeches/2016/2016-george-kansascity-02-02.pdf>

The Federal Reserve Bank of Kansas City values diversity of experience, industry, geography, race and gender on its Board of Directors.



Steve Maestas, Chair (Class C)
Chief Executive Officer
Maestas Development Group
Albuquerque, New Mexico



Brent A. Stewart Sr. (Class B)
President and CEO
United Way of Greater Kansas City
Kansas City, Missouri



Rose M. Washington, Deputy Chair (Class C)
Executive Director
Tulsa Economic Development Corporation
Tulsa, Oklahoma



Max T. Wake (Class A)
President
Jones National Bank & Trust Co.
Seward, Nebraska



Jim Farrell (Class C)
President and CEO
Farmers National Company
Omaha, Nebraska



Paul J. Thompson (Class A)
President and CEO
Country Club Bank
Kansas City, Missouri



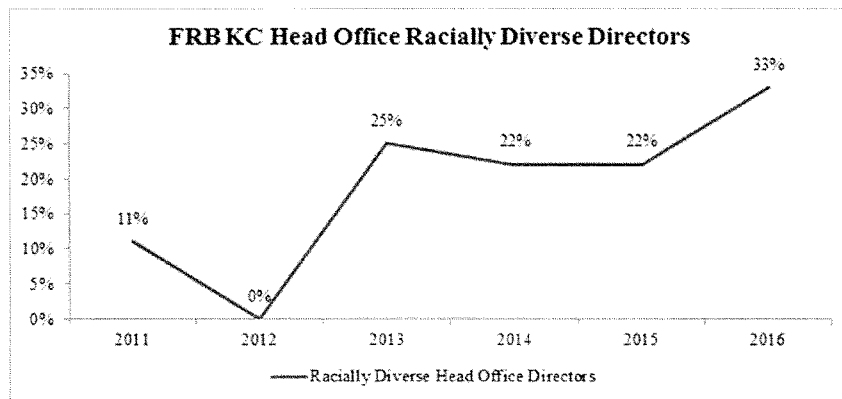
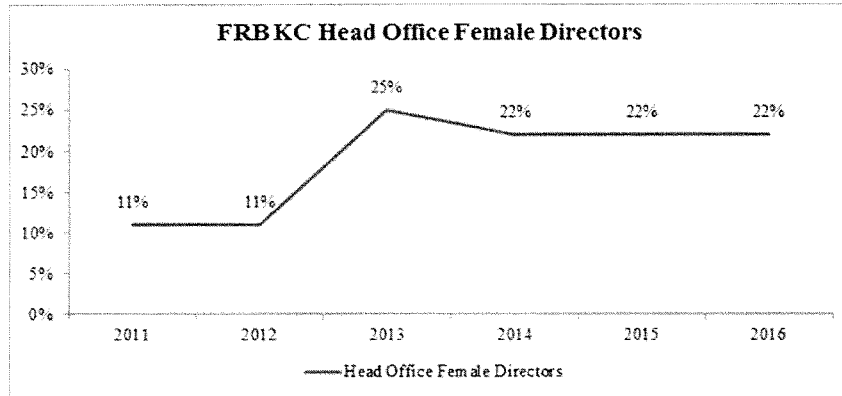
Len C. Rodman (Class B)
Retired Chairman, President & CEO
Black & Veatch
Overland Park, Kansas



Mark A. Zaback (Class A)
President and CEO
Jonah Bank of Wyoming
Casper, Wyoming



Lilly Marks (Class B)
Vice President for Health Affairs
University of Colorado
Anschutz Medical Campus
University of Colorado
Aurora, Colorado



PUBIC ENGAGEMENT SAMPLING

Esther L. George
President and Chief Executive Officer
Federal Reserve Bank of Kansas City

FED'S ESTHER GEORGE: SPEAKING UP FOR MIDDLE AMERICA

By Alister Bull
Reuters
Apr. 29, 2013

EL RENO, Oklahoma – Federal Reserve officials, as a rule, can expect a tough crowd when they visit places like Oklahoma where suspicion of big government runs deep.

Esther George, president of the Kansas City Fed, is an exception. As she surveyed the cattle ranchers, energy bosses and other business leaders waiting to hear her speak at an event in El Reno, Oklahoma this month, she had a lot in common with her audience.

Like many of them, George has become troubled that the dramatic measures the Fed has taken to restore U.S. growth might fuel inflation and asset price bubbles. ...

Full article:

<http://www.reuters.com/article/us-usa-fed-george-idUSBRE93S02M20130429>

FED BRANCH CHIEF HEARS TALES OF BANKING WOE FROM POT BUSINESS OWNERS

By David Migoya
Denver Post
Apr. 9, 2015

Federal Reserve Bank of Kansas City president Esther George on Thursday listened intently to a group of 20 businessmen, bankers and government officials who talked about the troubling lack of banking services available to the marijuana industry, but offered little indication how it could be resolved.

In the first meeting of its kind, George heard tales from marijuana business owners that ranged from one who was made to close more than a dozen bank accounts — each time leaving with an armful of cash — to another who described how a family member uninvolved with the enterprise was forced to close an investment account, according to people who attended the closed-door affair.

“The fact that she took the time to meet ... is a significant indicator of how seriously these issues are being taken now,” said Taylor West, deputy director of the National Cannabis Industry Association. “So even if there isn’t immediate action coming out of the meeting, it’s still definitely a positive step forward.” ...

Full article:

<http://www.denverpost.com/2015/04/09/fed-branch-chief-hears-tales-of-banking-woe-from-pot-business-owners/>

LABOR AWARDS HANDED OUT

The Labor Beacon

Kansas City, Mo.

April 2015

... (Greater Kansas City AFL-CIO President Pat "Duke") Dujakovich noted introducing keynote speaker (Esther) George that local AFL-CIOs around the nation were working to establish conversations with regional Federal Reserve Banks and thanks to George, the dialogue in Kansas City is excellent. The Kansas City Fed President makes a real effort to understand economic conditions on the ground in the region, he noted. ...

Full article:

<http://www.kclaborbeacon.com/Archived%20Publications/2015/April%2030,%202015%20Edition.pdf>

ON YOUR SIDE CONSUMER ALERT: WHAT ECONOMIC RECOVERY?

KAKE-TV

Wichita, Kan.

March 29, 2016

What economic recovery? That was the question some Wichita community leaders asked Kansas City Federal Reserve President Esther George.

One by one Wichitans shared their stories of financial hardship in an economy that many on Wall Street say has recovered.

"People below the one percent even the two percent, we are still struggling....there are days in which I am going home trying to figure out how I'm going to feed my kids," said Tye McEwen, a Sunflower Community Action member.

"They laid me off. No reason, no explanations, just hand me a slip and have a good day," said Desmond Bryant.

The woman across the table listening intently is Kansas City Federal Reserve President Esther George. For many people keeping interest rates low is important to stimulant economic growth among the poorest. As important as it is for President George to meet with Wichita community leaders, meetings likes this serve as a good way for the community to see just what the Federal Reserve can and cannot do.

Full article:

<http://www.kake.com/story/32139745/on-your-side-consumer-alert-what-economic-recovery>

**MEDIA COVERAGE AND ANNOUNCEMENTS NOTING
PUBLIC OVERSIGHT ROLE OF THE BOARD OF GOVERNORS**

KOHN HAD BOARD BACKING FOR NY FED WAIVER: OFFICIAL

By Alister Bull and Mark Felsenthal
Reuters
May 11, 2009

A waiver granted by Federal Reserve Vice Chairman Donald Kohn that allowed the chairman of the New York Fed's board of governors to stay in his job had the full backing of the Fed's Board of governors, including Chairman Ben Bernanke, a Fed official said on Monday.

The controversial waiver allowed Stephen Friedman to stay in his job as chairman of the board of governors of the New York Federal Reserve despite owning shares in Goldman Sachs, which the Fed began regulating in September.

Friedman, a retired chairman of Goldman Sachs, resigned last week after it was reported in *The Wall Street Journal* that he had bought more Goldman shares.

The Wall Street Journal called in an editorial on Monday for Kohn's resignation, and said he had shown a tin political ear by allowing Friedman to stay at the New York Fed.

Full article:

<http://www.reuters.com/article/businesspro-us-usa-fed-kohn-idUSTRE54B0FR20090512>

2016 RESERVE BANK BUDGET APPROVALS

On December 16, 2015, the Board approved the 2016 Reserve Bank operating budgets totaling \$4,116.6 million, an increase of \$219.9 million, or 5.6 percent, from the 2015 estimated expenses and \$147.9 million, or 3.7 percent, from the approved 2015 budget.

Full announcement:

http://www.federalreserve.gov/foia/2016rb_budgets.htm

NOT FAR TO LOOK: NEW FED PRESIDENT SEARCHED, FOUND HIMSELF

By Christopher Condon
Bloomberg
June 3, 2015

... Details of how (Patrick) Harker was appointed rankled a Philadelphia-based community group that had pressured the bank last year to be more open about how it would select a new chief.

"This just furthers our message about transparency and accountability," said Kendra Brooks, an organizer at Action United. "This is part of the problem we're talking about." The Philadelphia Fed is one of 12 regional Fed banks. Their presidents, together with the Fed's Board of Governors in Washington, set interest-rate policy for the U.S. economy.

Regional presidents are selected by their boards of directors under the Federal Reserve Act and must be ratified by the Fed's board.

The Fed board approved Harker's appointment in a 5-0 vote and was aware of his role in the search process, said Michelle Smith, a spokeswoman. The board was confident the search was thorough and robust, and that Harker had appropriately removed himself when he became a candidate, Smith said.

Full article:

<http://www.bloomberg.com/news/articles/2015-06-03/not-far-to-look-fed-s-newest-president-searched-found-himself>

ROBERT STEVEN KAPLAN NAMED PRESIDENT AND CEO OF DALLAS FED

News Release: Aug. 17, 2015

DALLAS—The Federal Reserve Bank of Dallas today announced the appointment of Robert Steven Kaplan as president and chief executive officer. In this role, Kaplan will represent the Eleventh Federal Reserve District on the Federal Open Market Committee in the formulation of U.S. monetary policy and will oversee the 1,200 employees of the Dallas Fed.

His appointment is effective September 8, 2015.

Kaplan, 58, is the Martin Marshall Professor of Management Practice and a Senior Associate Dean at Harvard Business School. He is also co-chairman of the Draper Richards Kaplan Foundation, a global venture philanthropy firm that invests in developing non-profit enterprises dedicated to addressing social issues.

Kaplan was appointed by eligible members of the Dallas Fed board of directors and approved by the Board of Governors of the Federal Reserve System. He succeeds Richard W. Fisher, who retired from the Dallas Fed in March 2015.

Full news release:

<http://dallasfed.org/news/releases/2015/nr150817.cfm>

NEEL KASHKARI NAMED NEXT MINNEAPOLIS FED PRESIDENT

By Christopher Condon

Bloomberg

Nov. 10, 2015

... Presidents of the 12 regional Fed banks are appointed by a portion of their respective boards of directors, subject to the approval of the Fed Board in Washington. Reserve bank boards typically consist of nine members, including three bankers. The banking members are excluded under Dodd-Frank from participating in the selection of presidents.

Full article:

<http://www.bloomberg.com/news/articles/2015-11-10/neel-kashkari-named-by-minneapolis-fed-as-its-next-president>

BOARD OF GOVERNORS APPROVES REAPPOINTMENT OF RESERVE BANK PRESIDENTS AND FIRST VICE PRESIDENTS

News Release: Feb. 19, 2016

The Federal Reserve Board on Friday approved the reappointment of 10 Federal Reserve Bank presidents and 10 first vice presidents by their respective boards of directors. Each individual has been approved to serve a new five-year term beginning March 1, 2016. The recently named presidents of the Federal Reserve Banks of Minneapolis and Dallas, as well as the recently appointed first vice presidents of the Federal Reserve Banks of Philadelphia and Chicago, were approved for terms to February 28, 2021, at the time of their initial appointments.

Under section 4 of the Federal Reserve Act, all Reserve Bank presidents and first vice presidents serve five-year terms that expire at the end of February in years ending in 1 or 6. Generally, presidents and first vice presidents who take office in intervening years are initially appointed for the remainder of the current term. Before the expiration of a president's term, the Class B and C directors of each Reserve Bank who are not affiliated with a supervised entity vote on whether to reappoint the president or first vice president to a new term.

"The leaders of the Reserve Banks have important jobs and are expected to perform at a high level," said Governor Jerome H. Powell, chairman of the Board's Committee on Reserve Bank Affairs. "The eligible Reserve Bank directors, with significant input from the Board of Governors, conduct a rigorous process to inform their reappointment decisions."

Full announcement:

<https://www.federalreserve.gov/newsevents/press/other/20160219a.htm>



FEDERAL RESERVE BANK of KANSAS CITY Diversity & Economic Inclusion Activities

Community Activities including standing advisory councils, special convenings, or special initiatives			
Name of Activity	Description	Key Actions and Expected Benefit	Time Frame
Strategic Stakeholder Engagement Program (SSEP)	<p>The SSEP builds mutually beneficial relationships with selected stakeholders and enhances their overall awareness of the FRB.</p> <p>Strategic stakeholders include:</p> <ul style="list-style-type: none"> • Senior Women Bankers • Minority Bankers • Emerging Bank Leaders • Community Leaders • Labor Leaders <p>The Bank engages with strategic stakeholders through targeted programs, research, resources and other support.</p>	<p>Actions</p> <ul style="list-style-type: none"> • Conducted needs and gap analysis for each group within each District state. In response, developed diverse networks and targeted programs and meetings to provide exposure to the Fed for underrepresented groups. • March 28-29, 2016, listening session with Sunflower Community Action and Center for Popular Democracy. • 2016 Community Leaders Roundtables: Oklahoma City (April 13); Kansas City (May 20); Omaha (Aug. 9); and, Denver (Sept. 27). • 2016 Labor roundtables: Kansas City (May 16); Denver (May 26); and, Oklahoma City (Oct. 12). • Minority Bankers Forum to be hosted Sept. 29, 2016, in Kansas City. <p>Benefits</p> <ul style="list-style-type: none"> • Mutually beneficial interactions with supporters and critics. • Enhanced understanding of the Federal Reserve. • Direct knowledge from diverse sources on economic realities and emerging trends. • Delivery of customized programs and resources that will benefit the stakeholders. • Broad and diverse candidate pool for Bank boards and councils. 	Ongoing
Community Development Advisory Council (CDAC)	<p>Established in 2001, the CDAC meets twice annually with senior management to offer its insight on economic and community development issues impacting low and</p>	<p>Actions</p> <ul style="list-style-type: none"> • Hosted annual meetings and an additional conference call with CDAC members and the three Tenth District members on the BOG's CAC. 	Ongoing

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Economic and Small Business Development	<p>moderate income communities. Members are from a wide background of organizations including financial institutions, nonprofits, universities and business from across the Tenth Federal Reserve District.</p>	<ul style="list-style-type: none"> • Launched an application process to let community development professionals express interest in joining the CDAC in 2017. 57 applications were received. • Proactively communicated relevant content (i.e., speeches, papers, articles) to CDAC members to enhance their knowledge and engagement with the FRS. <p>Benefits</p> <ul style="list-style-type: none"> • Bank Ambassadors: Council members are supportive, informed and engaged ambassadors for the Bank and the FRS. • Board Pipeline: CDAC members are a key pipeline for Bank boards of directors. Over the past five years, two CDAC members have joined branch boards. • Increased Diversity: 56 percent of CDAC members are minority and 56 percent are women. 	
Economic and Small Business Development	<p>The Bank's economic and small business development initiatives strengthen entrepreneurship-based economic development in urban and rural communities by providing practitioners and small business owners with industry knowledge, best practices, peer networks and access to capital sources.</p>	<p>Actions</p> <ul style="list-style-type: none"> • Hosted a sold-out, two-day national entrepreneurship-based economic development summit to build a stronger community of practice among economic and community developers. 220 attendees rated the overall effectiveness of the summit a 4.8 on a 5.0 scale. • Provided presentations on minority economic development, the impact of minority owned businesses on the economy and minority business trends. • Conducted a small business roundtable with the U.S. Small Business Administration on access to capital. • Led the formation of a state-wide CDFI coalition in Oklahoma to facilitate best practice and resource sharing and build a greater awareness of CDFIs with bankers and small business owners. A similar coalition has launched in Colorado. • Developing a best practice guide for CDFIs/microlenders that highlight organizations that provide reasonably priced and faster short-term capital options for small businesses. • Partnering with the New York Fed and nine other FRBs on the annual Small Business Access to Credit Survey. • Hosting a national webinar for the System on small business as an 	Ongoing

		economic development engine in hard-to-develop communities.	
		<p>Benefits</p> <ul style="list-style-type: none"> • Launch of the Oklahoma CDFI Coalition will increase financial and technical assistance products and services offered to small business owners and consumers. • Economic development practitioners, small business support organizations and small business owners have increased their knowledge of the importance of entrepreneurship-based economic development, effective ecosystems and options for capital. 	
Workforce Development	The focus of the Bank's workforce development initiative is to improve the employment outcomes of low-wage and low-skilled workers. Our "Raise the Floor, Build the Ladder" strategy brings employers, educators and funders together to identify growth sectors and develop plans to equip workers for success.	<p>Actions</p> <ul style="list-style-type: none"> • Hosted a series of national webinars and delivered presentations on the policies and practices highlighted in the Bank's <i>Transforming U.S. Workforce Development Policies for the 21st Century</i>. The book was a partnership with the Atlanta Fed. • Partnering with the Dallas Fed on a guide for bankers that outlines how CRA can be maximized to support workforce development initiatives. • Helping KC's workforce investment board, the Full Employment Council, fulfill certain requirements related to a \$5 million workforce development grant it received from the U.S. Department of Labor. The grant targets low-skilled LMI young adults interested in financial services, IT, advanced manufacturing or healthcare fields. The Bank will assist with financial education and mock employment interviews. Program graduates could become Bank employees. <p>Benefits</p> <ul style="list-style-type: none"> • Low-skilled workers will receive and utilize skills that make them employable for livable-wage careers. 	Ongoing
Financial Stability	The financial stability initiatives are focused on increasing public understanding of financial issues impacting LMI communities. Efforts are also focused on increasing the overall financial health of LMI adults by expanding the pool of social service professionals who are trained to	<p>Actions</p> <ul style="list-style-type: none"> • Organized a citywide, daylong event that provided a variety of financial education workshops for about 300 consumers. • Hosted two of four interactive workshops for social service professionals to train them on the content and delivery methods of Consumer Financial Protection Bureau's, "Your Money, Your 	Ongoing

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	adequately provide financial resiliency coaching.	<p>Goals” toolkit. The remaining workshops will be in August and September.</p> <ul style="list-style-type: none"> In October and November, the Bank will partner with Central New Mexico Community College to host a six-day Financial Coaching program for social service professionals. Graduates will be certified by the Center for Credentialing and Education to coach clients on financial and career related goals. Hosting a national conference on financial resiliency and mobility in September. <p>Benefits</p> <ul style="list-style-type: none"> Increased awareness of sound financial practices, available resources and credible resource providers. Social service professionals will acquire basic and advanced financial knowledge and a strong coaching framework that will enable them to effectively coach clients.
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Diversity and Inclusion/Office of Minority and Women Inclusion (OMWI) Activities			
Name of Activity	Description	Key Actions and Expected Benefit	Timeframe
Signature Diversity and Inclusion Summits	<p>Events designed to address a targeted diversity topic such as Women in Technology, Disability Inclusion and Unconscious Bias.</p> <p>Summits feature a subject matter expert keynote speaker to address the summit topic. Subsequent group discussions allowed attendees to share best practices. FRS guests and community leaders are invited to participate in each summit.</p>	<p>Actions</p> <ul style="list-style-type: none"> Hosted a Diversity and Inclusion Summit focused on Unconscious Bias, March 16, 2016, with 189 attendees. Hosted a Diversity and Inclusion Summit focused on Women in Technology, April 7, 2016, with 92 attendees. Hosted a Diversity and Inclusion Summit focused on Winning Strategies: Creating an Inclusive Organization, Aug. 11, 2016, with 82 attendees. <p>Benefits</p> <ul style="list-style-type: none"> Creates a forum around the importance of diversity and inclusion in our organizations and communities. Enhances both the community and Bank understanding of diversity and inclusion. 	Four per year
Diversity Strategy Steering Council (DSSC) and Employee Diversity Council (EDC)	<p>Diversity Strategy Steering Council</p> <ul style="list-style-type: none"> Comprised of members of senior management and other Bank officers. 	<p>DSSC Actions</p> <ul style="list-style-type: none"> The DSSC meets four times annually. 	Ongoing

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	<ul style="list-style-type: none"> • Advises the OMWI office on diversity opportunities and issues. • Provides the necessary leadership, guidance and resources to ensure diversity efforts are well supported and its strategies are achieved. <p>Employee Diversity Council</p> <ul style="list-style-type: none"> • Comprised of select staff chosen by Bank Division heads. • Coordinates activities that create awareness of diversity and inclusion as a business opportunity, increase employee awareness of diversity and inclusion and support the Bank's retention strategy. • Communicates information about Bank and community diversity and inclusion events to employees. 	<ul style="list-style-type: none"> • Reviews and refreshes the three-year diversity and inclusion strategy. • Champions and participates in diversity events and activities at the Bank. <p>EDC Actions</p> <ul style="list-style-type: none"> • The EDC hosted the annual Diversity and Inclusion Champions Retreat, Feb. 25, 2016, which brought together several internal diversity and inclusion groups to collaborate on the future of diversity and inclusion at the Bank as well as hear from external and internal speakers regarding the topic. • The EDC hosted the annual Diversity Awareness Week, Aug. 1-5, 2016, which consisted of a Ted Talk about Exclusion, Illusion, and Collusion; a Multicultural Showcase; and a Lunch and Learn with Kirk Penucca, who shared his perspective in an interactive session titled "Identifying Effective Cultural Competence for an Inclusive Work Environment." • EDC members and EEO Liaisons participate in an annual diversity and inclusion training in addition to the annual Diversity Retreat. <p>DSSC Benefits</p> <ul style="list-style-type: none"> • Provides strategic direction and executive championship in promoting diversity and inclusion in the workplace. <p>EDC Benefits</p> <ul style="list-style-type: none"> • Promotes an inclusive work environment by recognizing the diversity of the Bank's workforce and reinforcing employee awareness of key diversity issues. • Creates awareness of diversity and inclusion as a business opportunity. • Encourages Bankwide involvement in diversity and inclusion activities. • Members serve as a resource for the Bank and employees about diversity and inclusion related activities. 	
Diverse Bank Groups	The Bank sponsors two diversity groups, the Minority Members of Management and Women in Technology Community of Practice (WITCOP).	<p>Minority Members of Management Mentoring Circle Actions</p> <ul style="list-style-type: none"> • Hosted luncheon presentation with Brent Stewart, president and CEO of the United Way of Greater Kansas City, on career and 	Minority Members of Management Mentoring Circle meets four to six

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	<p>The mentoring circle is a forum for minority members of management to focus on professional development and diversity and inclusion in the workplace.</p> <p>WITCOP focuses on empowering current and aspiring women technologists at the Bank to achieve leadership through technology by engaging various mentoring, sharing and community outreach initiatives.</p>	<p>Leadership insights.</p> <ul style="list-style-type: none"> Members attend Diversity and Inclusion Summits and external Collaborative Partner events. Members participate in key diversity and inclusion development opportunities. <p>WITCOP Actions</p> <ul style="list-style-type: none"> Hosted an IT Professional Showcase for Bank employees that highlighted current IT opportunities at the Bank, allowed cross-functional interaction between Bank IT professionals, and provided first-hand knowledge on a day in the life of various technologists. WITCOP participated in the Women in Technology Signature Diversity and Inclusion Summit. <p>Minority Members of Management Mentoring Circle Benefits</p> <ul style="list-style-type: none"> Meets and discusses issues regarding diversity and inclusion in the workplace. Fosters growth and development for greater retention of minorities at the Bank. Provides key programming events throughout the year with internal and external guest speakers. Provides networking opportunities for emerging minority talent, minority members of management and minority Bank officers. <p>WITCOP Benefits</p> <ul style="list-style-type: none"> Nurtures value-creating interactions and provides platform of support and resources. Empowers members to be positioned to influence and/or drive planned and emergent technology innovations within the Bank. Improves information flow and knowledge by leveraging internal and external subject matter expertise. Develops the ability to sense and respond to key problems and opportunities in FRBKC's technology ecosystem. Focuses on community outreach through sharing, encouraging and facilitating opportunities to get involved in the community and encouraging girls and young women to choose a career in STEM. 	<p>times annually.</p> <p>WITCOP has quarterly sessions and monthly activities.</p>
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Mentorship Program	<p>The mentoring program connects an experienced Bank employee with a less-experienced employee in developing specific skills and knowledge that will enhance his or her professional growth. Outside of mentor/mentee meetings, employees in the mentoring program are invited to participate in four internal development activities, such as Yan-Jobba, a character education activity with roots in the cultures of Africa. It is an intellectual and highly participatory tool for character and multicultural engagement. Participants learn the concepts of compassion, respect, tolerance, trust, responsibility, interdependence and leadership in a fun, relaxed and enjoyable environment. Participants also have the opportunity to hear from external speakers on the importance of mentoring connections and participate in a speed mentoring event, a unique event formatted to share leadership success stories.</p>	<p>Actions</p> <ul style="list-style-type: none"> 2016 mentoring participation reached its highest level of participation with 454 employees, about 27.9 percent of the total workforce. Minority and female participation rates increased to 25 percent and 31.2 percent, respectively. <p>Benefits</p> <ul style="list-style-type: none"> Improves employee retention. Improves the overall quality and depth of our leadership team. Supports the Bank's diversity and inclusion objectives. Increases the number of minorities in management positions. Increases the success rate in hiring high-quality staff. 	<p>Mentor/Mentee Agreements are one year and relationships are ongoing.</p>
Supplier Diversity Practices	<p>The Bank's strategy on supplier diversity encourage acquisition of goods and services from diverse suppliers, including businesses owned by minorities and women. When the Bank makes competitive acquisitions, it carries out this strategy by seeking to include, when available, at least one business owned by a minority and one owned by a woman. The Bank affirms its commitment to supplier diversity by including language in its contracts that states its commitment to equal opportunity in employment and contracting. The contract language further states that by entering into a contract with the Bank, the contractor confirms a similar commitment in its own business practices.</p>	<p>Actions</p> <ul style="list-style-type: none"> Diverse suppliers are included in all competitive acquisitions when they are available. Diverse suppliers are identified through engaging in local, regional and national groups and organizations through outreach activities and events targeted to diverse suppliers. The Bank informs suppliers about its business practices and encourages their participation in contracting opportunities. <p>Benefits</p> <ul style="list-style-type: none"> Diversity in suppliers creates value by providing the Bank access to a wider pool of qualified suppliers. The community also benefits in that small and diverse businesses gain access to business opportunities. 	<p>Ongoing</p>
Supplier Outreach	<p>The Bank partners with local, regional and national organizations that focus on minority- and women-owned business members. Partner</p>	<p>Actions</p> <ul style="list-style-type: none"> The Bank has participated in seven outreach events and activities 	<p>Ongoing</p>

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	<p>organizations include the Asian American Chamber of Commerce of Kansas City, Heartland Black Chamber of Commerce, Mountain Plains Minority Supplier Development Council and Midwest Women's Business Enterprise Council.</p>	<p>this year and targets to attend at least 10 by year's end.</p> <ul style="list-style-type: none"> The Bank hosts several meetings with diverse suppliers to learn more about their work and to inform those suppliers about the Bank's general business needs and how to navigate the procurement practices. The Bank collaborates with other Federal Reserve Banks to develop and promote initiatives that strengthen supplier diversity. <p>Benefits</p> <ul style="list-style-type: none"> These partnerships help the Bank communicate business opportunities and build its network of diverse suppliers. Outreach events and activities provide staff with opportunities to network and connect with diverse suppliers, learn more about supplier diversity best practices and support the efforts of the Bank's community partners. 	
Name of Activity	Description	Key Actions and Expected Benefit	Time Frame
OMW1 Campus Recruiting	<p>Each year, a number of Bank employees visit college campuses spanning 10 states to recruit talent to the organization. Of these campuses, 14 are majority-minority and women-serving colleges and universities. A Diversity Liaison Program was created in which each team is assigned a team member to connect and build relationships with multicultural offices and diverse student organizations on majority-serving campuses. In addition, the Bank participates in the pilot HBCU/HSI systemwide initiative with Hampton and University of New Mexico. Minority and women-serving colleges the Bank partners with include:</p> <ul style="list-style-type: none"> Clark Atlanta University Colorado State University at Pueblo Cortey College 	<p>Actions</p> <ul style="list-style-type: none"> The recruiting team attends recruiting events at majority-minority and women serving colleges, delivers classroom presentations, and participates in mock interviews. The recruiting team has attended 15 events at majority-minority and women serving colleges and universities this year, and targets to attend 26 by year-end. Diversity Liaisons connect with multicultural offices and organizations on each campus. <p>Benefits</p> <ul style="list-style-type: none"> Increases the Bank's emphasis on attracting diverse talent from all campuses. Expands pool of diverse talent beyond the Tenth District. Supports the Bank's sourcing strategies and talent acquisition needs. 	Ongoing

<p>Collaborative Partners</p>	<ul style="list-style-type: none"> • Langston University • Lincoln University • Morehouse College • Prairie View A&M University • Saint Mary's College • Spelman College • Stephens College • Texas Southern University • Texas Women's University • University of Arkansas at Pine Bluff • University of New Mexico 	<p>Actions</p> <ul style="list-style-type: none"> • The Bank supports these organizations and seeks to continually enrich the partnerships by placing senior officials at key programs, events and speaking engagements. • Collaborative partners are invited to diversity and inclusion events at the Bank and are allowed to utilize Bank facilities for events. <p>Benefits</p> <ul style="list-style-type: none"> • Partnerships allow the Bank to expand its pool of qualified and diverse candidates through networking and relationship building. • Through partnering with these organizations, the Bank has the opportunity to attend professional networking events. • Networking events allow Bank employees to connect with the community while also providing an opportunity for networking and recruiting. • Enhances community understanding of the Bank's commitment to diversity and inclusion. 	<p>Ongoing</p>
<p>Director Pipeline Program</p>	<p>The Bank relies on real-time knowledge gleaned from business and community leaders from the Tenth District. In 2006, economists were placed as the lead officers in Denver, Oklahoma City, and Omaha. They are supported by a Public and Community Affairs</p>	<p>Actions</p> <ul style="list-style-type: none"> • Forty-three percent of the District's Board of Directors are women and/or minorities* representing a broad and diverse cross section of business and industry. <p><i>*A director who is both female and minority is counted just once</i></p>	<p>Annually</p>

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	team that enhances the District's ability to maintain a robust programming and public speaking schedule in each zone, thus attracting and retaining a diverse Board of Directors.	<p>Benefits</p> <ul style="list-style-type: none"> Branch boards create a diverse talent pool for sourcing Kansas City directors. Enhances understanding of the FRS and ensures people with diverse perspectives have input into national policy matters. 	Ongoing
Experienced Professional Recruiting	The Bank attracts experienced professionals through a variety of channels, including hosting professional networking events, attending national conferences and collaborating with national organizations.	<p>Actions</p> <ul style="list-style-type: none"> This year, the Bank has attended nine urban career fairs and 23 networking events with professional organizations in the community. <p>Benefits</p> <ul style="list-style-type: none"> Experienced professionals bring outside perspective to the Bank. Supports the Bank's sourcing strategies and talent acquisition needs Enhances the diversity of thought at the Bank. 	

Other Outreach/Education Activities			
Name of Activity	Description	Key Actions and Expected Benefit	Time Frame
Student Board of Directors	The annual Student Board of Directors program has provided mentoring and college and career development for students from urban high schools in Kansas City, Denver, Oklahoma City, and Omaha since 2012. Throughout the year, students meet with Bank employees and business leaders from the community to discuss topics such as career and college preparation, personal finance, public speaking and business etiquette.	<p>Actions</p> <ul style="list-style-type: none"> During the 2014-15 school year, 67 students across the District participated, including the first class from Albuquerque Public Schools. <p>Benefits</p> <ul style="list-style-type: none"> Provides mentoring and college and career development for students from urban high schools across the Tenth District. Participation in the program exposes students to a corporate environment and builds self-confidence. In addition to the immediate benefits students get, the Student Board of Directors also opens long-term relationships with the KC Fed. Two previous participants in the program were offered a full-time position with the Bank upon completion of a summer internship. 	Annual program
Summer @ the Fed	Students who complete the Board of Director program are invited each year to apply for paid summer internships as activities directors for Summer @ the Fed, an economics education summer program for low-to-moderate income	<p>Actions</p> <ul style="list-style-type: none"> In 2016, more than 750 fourth through sixth grade students participated in the summer camp program. 	Annual program

	fourth through sixth grade students in the Kansas City metro area. Student Board members share interactive economics education lessons with the students from June-August. Activities encourage financial literacy and an understanding of the Bank's role in the economy. Activities related to the summer program take place at the Bank's headquarters in Kansas City, our Money Museum and at offsite locations throughout the community.	Benefits <ul style="list-style-type: none"> The summer program gives these college-bound high school graduates the opportunity to boost their job skills with professional development activities and serve as role models and mentors to younger students. Participants also benefit from exposure to District directors. The camp participants benefit from early exposure to financial education concepts delivered in a fun and culturally relevant way. 	
Financial Education Day	Each Tenth District office sponsors a program with a majority-minority high school or youth programs for Federal Reserve Financial Education Day. The annual program focuses on college and career readiness for diverse high school students, and incorporates financial capability fundamentals along with the concepts of educational attainment.	Actions <ul style="list-style-type: none"> On Oct. 28, the Bank will host 400 high school students for Financial Education Day. Benefits <ul style="list-style-type: none"> Increases financial literacy in the community. 	Annual program
KC STEM Alliance-Girls in Technology	Program aimed at exposing middle- and high-school-aged girls to computer science education programs. Programming includes networking and the Hour of Code, an activity that helps youth practice their website-building skills with assistance from mentors. Bank employees serve as mentors to the participants.	Actions <ul style="list-style-type: none"> The Bank hosted a kick-off event for Computer Science Education Week in 2015. The Bank coordinated volunteers for a weeklong Girls App Camp, hosted by KC STEM Alliance in 2016. Benefits <ul style="list-style-type: none"> Exposes, engages, excites, and encourages female participation in computer science educational programs to build a stronger and more diverse technology workforce for the Kansas City region. Addresses an increasing demand for a qualified and diverse workforce to fill tech jobs in the Kansas City region. 	Annual program

Payments System Activities			
Name of Activity	Description	Key Actions and Expected Benefit	Time Frame
Payments Research	Some of the Bank's research focuses on the unbanked and access to the U.S. payments system.	Actions <ul style="list-style-type: none"> Research efforts lead to articles published in Bank journals and other publications. For example, an upcoming article in the Bank's 	Ongoing

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			<p><i>Economic Review</i> is on "Access to Electronic Payments Systems by Unbanked Consumers."</p> <p>Benefits</p> <ul style="list-style-type: none"> Allows for better understanding of issues related to the unbanked and to influence policymakers. 	
Research/Monetary Policy Activities				
Name of Activity	Description	Key Actions and Expected Benefit		Time Frame
Math X Economics	The program introduces inner-city students to economics as a possible course of study in college and as a career option. During the one-day program, high school juniors and seniors take part in interactive and fun activities to introduce them to economics and learn about potential career paths. Sessions also include small group discussions where students are engaged in the discussion.	<p>Actions</p> <ul style="list-style-type: none"> 50 students participate in the program annually. <p>Benefits</p> <ul style="list-style-type: none"> Helps diversify the pool of job candidates in economics for both research associate and economist positions. 		Annually each spring.
American Economic Association's Summer Economics Fellows Program sponsored by the Committee on the Status of Women in the Economics Profession and also administered by the Committee on the Status of Minority Groups in the Economics Profession	Summer economic fellowships are available to senior graduate students and junior faculty who are women or underrepresented minorities in economics in the area of macroeconomics or monetary policy.	<p>Actions</p> <ul style="list-style-type: none"> During their internship, fellows present research seminars, make progress on their research agenda, participate in department activities and engage research staff members. <p>Benefits</p> <ul style="list-style-type: none"> Advances the participation of women and underrepresented minorities in the economics profession. 		We usually host one Summer Fellow for 10 to 12 weeks each year.
Support Speakers Series	Research staff supports several diversity and inclusion programs by speaking at events such as advisory councils, forums, roundtables, workshops and teacher/student events.	<p>Actions</p> <ul style="list-style-type: none"> Members of the Research Division speak at key diversity and inclusion events, both internally and externally. <p>Benefits</p> <ul style="list-style-type: none"> Supports diversity and inclusion activities across the Bank. 		Throughout the year as needed.

Distinguished Members of The Monetary Policy and Trade Subcommittee of the U.S. House Financial Services Committee:

As Chairman and CEO of Old National Bancorp, and a former board director of the Federal Reserve Bank of St. Louis, as well as a former member of the Federal Advisory Committee of the Federal Reserve Board, it is my distinct privilege to share with you my thoughts, and address your questions, about the role – and tremendous value – of directors representing banks of all sizes on our Reserve Bank boards.

I believe it is critically important that our nation's bankers continue to serve as directors on our Reserve Bank boards. To make it clear why I feel so strongly about this position, I first want to highlight for the Committee some initiatives and accomplishments of the bank that I lead. This is not an attempt to shine a spotlight on Old National; instead, it is intended to illustrate the powerful connection that community banks like ours enjoy with the communities we serve.

With \$14.4 billion in assets and a 182-year legacy of service, Old National is a fairly typical community bank. We are literally headquartered on Main Street, on the shore of the Ohio River in Evansville, Ind. Our clients are small and mid-sized business owners, farmers, young families, retirees. They span multiple sectors, industries and geographies, and they trust us to guide them. And like many community banks, we also serve as a catalyst within our communities for economic development, working to forge and strengthen partnerships among business leaders, community leaders and representatives of state and local government.

Also typical of banks throughout our great nation, Old National is known for our commitment to the communities we serve. In 2015, we supported our communities with more than \$5 million in grants and sponsorships, which were primarily focused on economic development, financial literacy and support for low-to-moderate-income families and individuals. Our nearly 3,000 associates also donated over 100,000 volunteer hours (every associate enjoys two paid volunteer hours a month) at more than 2,000 community organizations throughout our four-state footprint of Indiana, Kentucky, Michigan and Wisconsin. Old National has also been named one of the Ethisphere Institute's "World's Most Ethical Companies" for five consecutive years, and *American Banker* magazine recently named us as one of the best banks to work for in the nation.

We are also an organization focused on, and committed to, diversity and inclusion. This is evident in our Corporate Board of Directors, which includes former Indiana Lt. Governor Becky Skillman as lead director, as well as director Kathy White, a former Instructor of Law at West Point and the current Command Judge Advocate for the 46th Military Police Command in Ann Arbor, Mich., and Derrick Stewart, CEO of the YMCA of Southwestern Indiana. Additionally, a Community and Social Responsibility subcommittee governed by our Corporate Board guides our efforts to be a socially responsible, sustainable and highly inclusive organization.

Another strength of our nation's banks, large and small, is providing financial education and financial literacy resources to at-risk members of our communities, especially low-to-moderate income (LMI) individuals and families. In 2015, Old National associates taught 900 financial education sessions in our markets, reaching more than 17,000 individuals (45,000 since 2013) and prompting the American Bankers Association to recognize us with two 2015 Community Commitment awards.

Again, I highlight these accomplishments to illustrate the unique and powerful connection that our nation's banks share with the communities we serve. Not only do bankers support a diverse range of individuals in our role as community catalysts, we're on the front lines every day helping our clients manage and grow their

businesses. They trust us to understand the dynamics of the market and to help them overcome any challenges and concerns. Over time, this relationship provides us with vital insights about how “Main Street Americans” truly view the economy, and how those views shape their decision-making.

As bankers, we also have the ability to reach out to our most trusted clients from multiple sectors, geographies and industries to seek information that can be used by our nation’s Reserve Bank boards to guide their thinking on key issues. This strong connection affords us access to multiple voices in our regions – from tech industry leaders to shop owners to middle-market managers – who are ready to share the kinds of candid thoughts and perspectives that don’t always show up in the national data.

Conversely, the bankers who sit on our nation’s Reserve Boards gain incredibly valuable information from the board table that they can take back to their communities. It truly is a reciprocal relationship that strengthens both the Federal Reserve and our nation’s cities and towns. I experienced this first-hand as a board director of the Federal Reserve Bank of St. Louis from 2008-13. Fueled by the knowledge and insights I gained as a Reserve Board director, Old National Bank spearheaded the creation of the first “Bank On” program in the Midwest. Launched in 2009 through a partnership with local government, financial institutions, community organizations and the St. Louis Fed, *Bank on Evansville* was modeled after the *Bank On San Francisco* initiative. Featuring LMI-specific products geared toward serving the unique needs of the unbanked and underbanked populations, the program was managed by an associate that Old National “loaned” to the project. In the nearly eight years since *Bank on Evansville* was launched, Old National has been the catalyst in creating another 16 *Bank On* programs in our footprint, helping roughly 2,200 unbanked or underbanked community members take greater control of their finances.

During my tenure as a Reserve Board director, I worked with a number of honorable, dedicated bankers, including Tommy May, Bryan Jordan and Ernie Chappel. While each of us represented a different market and perspective, we shared the common belief that together we could make our region and our nation stronger. As a director, I also spoke frequently with leaders of communities throughout the Old National footprint to gain their feedback about issues that were germane to our Regional Board. Over time, many of these leaders began seeking me out, unsolicited, to offer their unique Midwestern perspectives on the issues of the day. These discussions were invaluable to me and to our Reserve Bank President to assist him in his role on the Federal Open Market Committee (FOMC).

As I stated at the beginning of these remarks, I believe our nation’s bankers should continue to serve as directors on our Reserve Bank boards. As representatives of our region, we serve a limited yet crucial role. This includes providing detailed, systematic and real-time input about local economic conditions, which serves to help shape effective monetary policy. We also play a vital role in the business side of running a Reserve Bank, including management, strategic plans, operations, budgets and supervising internal audit functions. These are the crucial areas where the business expertise and leadership of our nation’s bankers – and the broad cross-section of voices and constituencies we serve – have proved to be a highly effective resource.

I am aware that concerns have surfaced over whether bank directors on Reserve Boards might somehow attempt to control or manipulate decisions for the betterment of their own institutions. I believe this issue is effectively addressed, and the potential risks are properly mitigated, through the letter of the law and the current policies and procedures of the Federal Reserve System. As this committee knows well, the banking industry is highly regulated, and our actions as bankers are carefully examined by multiple regulators. As bankers, we also understand the consequences to our institution if we violate these regulations. These same consequences apply to the regulations and policies that govern the Federal Reserve System. The existing governance model is very strong, and I applaud the controls currently in place. I can assure you that during

my tenure on the board, I was never placed in a position where I felt my integrity or ethical center were in any way compromised. Ultimately, exercising banking supervision and regulatory authority is the responsibility of the Board of Governors, not of our Reserve Bank boards.

As I stated earlier, our nation's bankers play a limited yet crucial role in our Federal Reserve System. Driven by a reciprocal relationship with the communities we serve, we provide an important voice and a powerful resource that help keep our Reserve Boards strong, balanced and effective. I encourage this committee to do everything in its power to retain this vital link to the views, perceptions and attitudes of Main Street America.

Thank you,

Bob Jones
Chairman and CEO
Old National Bancorp

Statement

**Subcommittee on Monetary Policy and Trade of the House Financial Services Committee
September 7, 2016**

**Jeffrey M. Lacker
President
Federal Reserve Bank of Richmond**

**Rayburn House Office Building
Washington, D.C.**

Good morning. I am honored to speak to the Subcommittee about the governance structure of the Fed's regional Reserve Banks.¹

To understand the Fed's structure, it is essential to understand the Fed's purpose. Prior to the founding of the Fed, the banking system was often unable to adjust the supply of monetary assets flexibly enough in response to the changing needs of commerce. The Fed was founded to "furnish an elastic currency," in the words of the preamble to the Federal Reserve Act. Clearinghouses – bank-owned cooperatives in larger cities – played an important role in how periodic crises were resolved before the Fed, including the issuance of currency substitutes, but were widely viewed as favoring the interests of large money center banks. Reserve Banks were modeled after the clearinghouses, but with note issue powers and universal eligibility for membership, the aim being to improve upon the role of the clearinghouses in a way that served broader public interests. A plan for a centralized institution was rejected out of concern about excessive Wall Street influence at the expense of diverse regional interests. Proposals for a government-controlled central bank were rejected as well for fear the federal government would use control of the money supply to resort to inflationary deficit financing. At the same time, a measure of public sector oversight was viewed as essential, consistent with Progressive Era thinking, so the Act included a Federal Reserve Board whose leaders were politically appointed.

Thus, the final Federal Reserve Act reflected a balance of competing considerations: a federated set of institutions to provide for representation of a diverse range of geographic and commercial interests, with a hybrid public-private governance structure to provide for public oversight but contain potential misuse of monetary authority.

The governance structure of the Federal Reserve is still effective, in my view, because the considerations the founders wrestled with are all still relevant today. The federated structure has benefited policymaking by ensuring that a diversity of perspectives on policy and economic conditions are brought to the table. Reserve Banks historically have shown intellectual leadership on topics that initially went against the grain of mainstream thinking but later became broadly accepted, and Reserve Bank presidents have a record of challenging conventional views. In addition, the federated structure has promoted broad regional engagement across the country, deepening the Fed's understanding of the diverse economic challenges facing American communities.

To be sure, our country's understanding of diversity has expanded since 1913. And it is in keeping with the spirit of our founding that the Federal Reserve has taken the importance of diversity seriously as we have sought to ensure broad representation of views in the formulation of monetary policy, including

those associated with disadvantaged communities. I believe our record in this regard, like that of many other organizations, shows a combination of substantial progress and areas where more can be done.

In addition to bringing diverse viewpoints to bear, the Fed's public-private governance helps our policymaking focus on its longer-term objectives. At times there is a temptation to provide excessive economic stimulus in the short run and leave the subsequent inflationary costs for future policymakers to deal with. Evidence from around the world, along with our own history, amply demonstrates that the temptation of short-sighted monetary policies is a bipartisan vulnerability, just as the Fed's founders feared. For central banks, this implies that meeting-to-meeting monetary policy decisions need to be insulated from short-term political pressures driven by electoral considerations.

But independence with regard to the choice of monetary policy instrument settings must be paired with strong accountability for the economic results of policymaking over time. Accountability rests on transparent communications, which help Congress and the public evaluate the Fed's performance against its mandate.

The Fed's public-private structure supports monetary policy independence by ensuring a measure of apolitical leadership. The Reserve Banks' autonomous balance sheets, protected appropriations status and independent capital stocks all play a role as well by limiting high-frequency interference that might diminish instrument independence.

The presence of bankers on Reserve Bank boards is said to represent a conflict of interest since Reserve Bank staff supervise banks. But strict rules limit bankers' roles; they simply have no avenue through which they can influence supervisory matters. Moreover, best practice for any board is to seek members with expertise relevant to the organization's activities. The Fed's large payment processing operations make the original rationale for having bankers serve on Reserve Bank boards still valid. In addition, bankers are particularly well-positioned to report on economic conditions in their footprints.

In conclusion, while some claim that the Federal Reserve's governance structure is a historical anachronism, the continued relevance of the trade-offs taken into account by the authors of the Federal Reserve Act argues for the continued utility of the finely balanced arrangements they crafted.

Thank you.

¹ My remarks reflect my own views and not those of my colleagues in the Federal Reserve System.

**Federal Reserve Bank Governance
September 6, 2016**

**Jeffrey M. Lacker
President
Federal Reserve Bank of Richmond**

The governance structure of the Federal Reserve Banks has been the subject of public discussion lately.¹ I'd like to provide some background on why the Fed is structured the way it is and the important purposes that structure serves – particularly to the monetary policymaking process that is core to the Fed's existence.²

How Our Structure Came to Be

To understand the Fed's structure, it is essential to understand the Fed's purpose.

The Fed's founders sought to address what they called "the currency problem." This referred to the inability of the economy's supply of notes and bank reserves – what today would be called the money supply – to expand and contract with the needs of commerce. A number of features of the pre-Fed monetary system contributed to the problem: Currency was issued by national banks and was required to be backed by U.S. Treasury securities, making note issuance costly and slow. And widespread branching restrictions resulted in thousands of small, undiversified banks throughout the country, which meant that a substantial portion of banks' reserves were held as interbank deposits. Overall, the financial system was vulnerable to shocks and unable to quickly move reserves to where they were needed, resulting in interest rate spikes that hampered economic activity on a frequent basis.³ Clearinghouses – bank-owned cooperatives that settled payments in larger cities – played an important role in how periodic crises were resolved. They could not legally issue currency, but they issued certificates that were circulated by their members as an (imperfect) substitute currency when the demand for currency surged.⁴

The Fed was created to "furnish an elastic currency," so that the supply of monetary assets would vary with the needs of economy. Reserve Banks, in turn, were modeled after clearinghouses. The operation of clearinghouses, however, was limited to the cities. The idea of the founders was to mimic and improve upon this model to serve broader public interests. They sought to create a system of institutions with *universal eligibility* for membership, so all banks would have access to clearinghouse services. The new institutions would have the ability to issue currency and would accept bank deposits to prevent reserves from "pyramiding" in large cities.⁵

A key debate at the founding of the Federal Reserve was how such a system should be governed.⁶ A primary concern of the founders was the extent to which the economic characteristics of large money centers and the rest of the country diverged. The initial legislative proposal was the Aldrich Plan, which provided for an elastic currency issued by a single National Reserve Association. That plan was rejected out of concern about excessive Wall Street influence at the expense of diverse regional interests. Proposals for a government-controlled central bank were viewed as risky for fear that the federal government would use control of the money supply to resort to inflationary deficit financing. At the same time, a measure of public sector oversight was viewed as essential, consistent with Progressive Era thinking. So the Act included a federal authority – the Federal Reserve Board, today called the Board of Governors – to oversee regional Reserve Banks' operations and policies, and whose leaders were politically appointed.⁷

Thus, the final Federal Reserve Act reflected a balance of competing considerations: a federated set of institutions to provide for representation of a diverse range of geographic and commercial interests, with a hybrid public-private governance structure to provide for public oversight but contain potential misuse of monetary authority.

The governance of the individual Reserve Banks was also designed to be a blend of public and private elements. Like clearinghouses before them, Reserve Banks are capitalized by their members through the purchase of stock rather than capitalized by the government.⁸ Reserve Bank stock is unlike traditional corporate stock, however, in that it comes with no voting rights and is not transferrable. Each Reserve Bank is governed by a nine-member board of directors that is partly public, with three members appointed by the Board of Governors, and partly private, with six members elected by member banks. By statute, six of the nine directors represent the public, not banks. The Reserve Banks' CEOs – originally called governors and today called presidents – are appointed by the boards but require the approval of the Board of Governors.

Why is This Structure Still Relevant Today?

The structure and governance of the Federal Reserve is still effective today because the considerations the founders wrestled with are all still relevant. While the nature of our economy and financial markets have changed in many ways since the founding of the Federal Reserve, the federated structure still ensures that a diversity of perspectives on monetary policy and economic conditions are brought to the table. Each Reserve Bank president, supported by an independent staff of economists, conducts his or her own analysis. In addition, the presence of geographically dispersed, independently chartered institutions has promoted broad regional engagement across the country, deepening the Fed's understanding of the diverse economic challenges facing American communities.⁹

There is evidence that Reserve Bank presidents are more willing than governors to challenge conventional views and that this has benefited policymaking. First, presidents have been more likely than governors to dissent on Federal Open Market Committee (FOMC) decisions, especially since the Great Moderation.¹⁰

Second, there are historical episodes in which the scope for diverse views served monetary policy well. In the 1960s and 1970s, Reserve Banks led the charge within the Fed on the idea that monetary policy was primarily responsible for inflation. The St. Louis Fed was an early proponent of monetarist views, which for a time earned it a reputation as a "maverick" bank but later became widely adopted. The Minneapolis Fed showed similar early leadership by questioning the idea that there was a stable trade-off between inflation and unemployment. These were more than academic debates; within the Fed, they directly supported the eventual development and acceptance of policies under Paul Volcker and Alan Greenspan that brought high and unpredictable inflation to an end. And in several key instances, Reserve Banks have continued to show intellectual leadership on topics that initially went against the grain of mainstream thinking but later became broadly accepted.¹¹

To be sure, our country's understanding of diversity has expanded since 1913.¹² And it is in keeping with the spirit of our founding that the Federal Reserve has taken the importance of diversity seriously as we have sought to ensure broad representation of views in the formulation of monetary policy, including those associated with disadvantaged communities. I believe our record in this regard, like that of many other organizations, shows a combination of substantial progress and areas where more can be done.

Governance and Monetary Policy Independence

In addition to bringing diverse viewpoints to bear, the Fed's public-private structure helps our policymaking focus on its longer-term objectives. Monetary policy can stimulate economic activity in the short run, but these effects are generally temporary; over time, monetary policy mainly affects inflation. At times there is a temptation to provide excessive economic stimulus in the short run and leave the inflationary costs, which often are evident only later, for future policymakers to deal with. For central banks, this implies that meeting-to-meeting monetary policy decisions need to be insulated from short-term political pressures driven by electoral considerations.

This is not just a theoretical argument: Across the history of central banks around the world, when monetary policy has been subject to high-frequency political winds, the results have not been good.¹³ And our own history shows that the temptation of short-sighted monetary policies is a bipartisan vulnerability, just as the Fed's founders feared. In the 1960s and 1970s, for example, the Fed came under pressure from the Johnson and Nixon administrations to pursue accommodative policies, setting off a cycle of so-called "go-stop" policy, in which rising inflation would ultimately force the Fed to raise rates abruptly, causing a recession.¹⁴

The lesson from these episodes is clear: Monetary policy independence is essential to achieving good economic outcomes. Undue political influence can and did happen even under our current structure, and as a country we should be wary of changes to Fed governance that could make such breaches easier. Nations around the world came to similar conclusions in the 1980s and 1990s – after long, hard struggles to tame inflation – that central banks delivered better results when insulated from short-run political pressures. Most accordingly structured their monetary policy decision-making processes to include independence.

Independence has its limits, however. Independence with regard to short-term choices of monetary policy instrument settings – that is, policy interest rates – must be paired with strong accountability for the economic results of policymaking over time. The economics literature has contrasted "instrument independence," which we have, with "goal independence," which we do not¹⁵: Congress sets the Fed's monetary policy objectives, and the FOMC chooses a succession of instrument settings in pursuit of them.

Accountability rests on the Fed's transparent communications, which help Congress and the public evaluate the Fed's performance against its mandate. The chair delivers a Monetary Policy Report to Congress twice per year and testifies semiannually, and all Fed leaders give occasional testimonies, speeches and interviews. The FOMC also provides considerable real-time information on its policy decisions: interest rate settings and voting records are immediately available the day of the meeting; the chair holds a press conference after every other FOMC meeting; the Fed's balance sheet is published weekly; the forecasts of FOMC members are published four times per year; and meeting minutes are released three weeks after each meeting (with full transcripts released after five years).

The Fed's public-private structure plays an important role in supporting monetary policy independence. The Fed has independent control of its balance sheet in terms of deciding which assets to buy and accept as collateral (within certain constraints provided by the Federal Reserve Act) and when to buy them. We also are self-funded and excluded from the federal appropriations process. In this regard, Reserve Bank capital, contributed by member banks, serves as an additional pillar of policy (instrument) independence by conveying a sense of self-sufficiency to market participants. And while the Fed's operations are audited extensively, monetary policy has a limited exclusion from federal audit by the Government Accountability Office. All of these measures serve to limit high-frequency interference that might diminish instrument independence.

The public elements of the Fed's hybrid structure provide balance and accountability. Governors are appointed by the U.S. president and confirmed by Senate. The Board, in turn, selects three directors for every Reserve Bank board, including the chair, and also must approve the selection of Reserve Bank presidents. And when the Board is fully staffed, Board members outnumber presidents on the FOMC.

Bankers on Boards of Directors

The presence of bankers on Reserve Bank boards has attracted attention of late. It is said to represent a conflict of interest since Reserve Bank staff supervise banks. But strict rules limit bankers' roles. No director is involved in, nor provided information about, the supervisory decisions or outcomes for specific institutions, and federal criminal statutes against conflicts of interest apply to directors, including those banning them from participating in decisions in which they knowingly have a financial interest. Directors representing banks are not allowed to participate in the process of selecting new Reserve Bank presidents, and the Board of Governors has final approval over such selections. Directors, and indeed Reserve Banks, have no formal role in crafting banking regulations; this is the authority of the Board of Governors. In short, bankers have no avenue through which they can influence supervisory matters.

Moreover, best practice for any board is to seek members with expertise relevant to the organization's activities. Indeed, this is why it makes sense for members to serve on the boards of joint venture associations, such as clearinghouses. Payments processing remains core to Reserve Banks' business: Fed systems move \$4.5 trillion in payments every single day. Thus, the original rationale for having bankers serve on Reserve Bank boards is still valid. Buttressed with the Board of Governors, the Reserve Bank boards have direct oversight responsibility for operations on which bankers arguably are experts. In addition, bankers have broad contact with consumers and businesses in their footprints, which makes their reports on economic conditions particularly useful.

More broadly, Reserve Bank boards have always been structured to represent diverse views, and their diversity has increased over time. For example, though it was natural to have bankers on boards, the original Federal Reserve Act mandated that a majority of directors represent the public. The Act also required the representation of varied commercial interests, which was expanded in 1977 to include "due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor and consumers." Over time, boards have come to include a much broader representation of professions, races and genders.¹⁶

Meanwhile, the role of boards in monetary policy has decreased. Before 1935, the boards essentially set monetary policy for their districts; they had far more control than even the Board of Governors. This reversed with the Banking Act of 1935, and now the role of Reserve Bank boards in monetary policy is strictly advisory: Directors provide crucial insight on local economic conditions, but their recommendation on discount rates is nonbinding.

In other corporate settings, potential conflicts of interest are viewed as manageable, and I believe they are well managed in the Fed's case. To be sure, however, the Fed could do a better job of educating the public about its safeguards.

Conclusion

I stated at the outset that the proper governance structure of the Fed ought to be driven by a deep understanding of the Fed's purpose.

Many aspects of the Fed and our financial system have changed since the Fed's founding, and some claim that the Federal Reserve's governance structure is a historical anachronism. Nevertheless, our core

function – providing stable monetary conditions to facilitate economic activity – remains unchanged. And the continued relevance of the trade-offs taken into account by the authors of the Federal Reserve Act argues for the continued utility of the finely balanced arrangements they crafted.

Thank you.

¹ See, for example, Jordan Haedtler, Andrew Levin, and Valerie Wilson, “Making the Federal Reserve Fully Public,” Economic Policy Institute, August 22, 2016; and Narayana Kocherlakota, “The Decentralized Central Bank: A Review Essay on ‘The Power and Independence of the Federal Reserve’,” August 29, 2016, *Journal of Economic Literature*, forthcoming, included within Narayana Kocherlakota, “Four Ways to Reform the Fed,” Bloomberg View, August 30, 2016.

² These remarks reflect my own views and not those of my colleagues in the Fed System. I am grateful to Renee Haltom and John Weinberg for their assistance in preparing these remarks.

³ Charles W. Calomiris and Stephen H. Haber, *Fragile by Design: The Political Origins of Banking Crises and Scarce Credit*, Princeton, N.J.: Princeton University Press, 2014.

⁴ For more on this history, see Jeffrey M. Lacker, “A Look Back at the History of the Federal Reserve,” Speech at Christopher Newport University, Newport News, Va., August 29, 2013. Also see: Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States: 1867–1960*, Princeton: Princeton University Press, 1963; Gary Gorton and Donald Mullineaux, “The Joint Production of Confidence: Endogenous Regulation and Nineteenth Century Commercial-Bank Clearinghouses,” *Journal of Money, Credit and Banking*, November 1987, vol. 19, no. 4, pp. 457–468; Allan H. Meltzer, *A History of the Federal Reserve*, Vol. 1, Chicago: University of Chicago Press, 2003; Richard Timberlake, “The Central Banking Role of Clearinghouse Associations,” *Journal of Money, Credit and Banking*, February 1984, vol. 16, no. 1, pp. 1–15.

⁵ For background on the objectives of the Fed’s founders, see Roger Lowenstein, *America’s Bank: The Epic Struggle to Create the Federal Reserve*, New York: Penguin Press, 2015; Eugene White, *The Regulation and Reform of the American Banking System, 1900–1929*, Princeton: Princeton University Press, 1983; and Elmus Wicker, *The Great Debate on Banking Reform: Nelson Aldrich and the Origins of the Fed*, Columbus: Ohio State University Press, 2005.

⁶ For detail on these debates, see especially Wicker (2005), and George Selgin, “New York’s Bank: The National Monetary Commission and the Founding of the Fed,” Cato Institute Policy Analysis No. 793, June 21, 2016.

⁷ See Wicker (2005), and Helen Fessenden and Gary Richardson, “The Cost of Fed Membership,” Federal Reserve Bank of Richmond Economic Brief No. 16-02, February 2016.

⁸ Fessenden and Richardson (February 2016).

⁹ Marvin Goodfriend, “The Role of a Regional Bank in a System of Central Banks,” Federal Reserve Bank of Richmond Economic Quarterly, Winter 2000, vol. 86, no. 1, pp. 7–25; and Kocherlakota (2016).

¹⁰ Daniel L. Thornton and David C. Wheelock, “Making Sense of Dissents: A History of FOMC Dissents,” Federal Reserve Bank of St. Louis Review, Third Quarter 2014, vol. 96, no. 3, pp. 213–228.

¹¹ Michael Bordo, “Some Historical Reflections on the Governance of the Federal Reserve,” in *Central Bank Governance & Oversight Reform*, edited by John H. Cochrane and John B. Taylor, Stanford, Calif.: Hoover Institution Press, 2016. Earlier working paper version available [here](#).

¹² Helen Fessenden and Gary Richardson, “Whom Do the Federal Reserve Bank Boards Serve?” Federal Reserve Bank of Richmond Economic Brief No. 16-08, August 2016.

¹³ Alberto Alesina and Andrea Stella, “The Politics of Monetary Policy,” in *Handbook of Monetary Economics*, Vol. 3, edited by Benjamin M. Friedman and Michael Woodford, Netherlands: Elsevier, 2010, pp.1001–1054.

¹⁴ For more on the political pressures that jeopardized the Fed’s independence in the 1960s and 1970s, see Robert P. Bremner, *Chairman of the Fed: William McChesney Martin Jr., and the Creation of the Modern American Financial System*, New Haven: Yale University Press, 2004; Robert Hetzel, *The Monetary Policy of the Federal Reserve: A History*, Cambridge: Cambridge University Press, 2008, Chapter 12; and Allan H. Meltzer, *A History of the Federal Reserve*, Vol. 2, Book 1, Chicago: University of Chicago Press, 2009, Chapter 4.

¹⁵ Alesina and Stella (2010).

¹⁶ Fessenden and Richardson (August 2016).



Richmond ■ Baltimore ■ Charlotte

Supplemental Materials

1. Jeffrey M. Lacker speech on the Fed's history and structure. Jeffrey M. Lacker, "A Look Back at the History of the Federal Reserve," Speech at Christopher Newport University, Newport News, Va., August 29, 2013.
 - *Full text attached.*
2. Richmond Fed article on the evolution of Reserve Bank boards of directors. Helen Fessenden and Gary Richardson, "Whom Do the Federal Reserve Bank Boards Serve?" Federal Reserve Bank of Richmond *Economic Brief* No. 16-08, August 2016.
 - *Full text attached.*
 - Abstract: The long-standing governance model of the Federal Reserve Banks, including their boards and the directors who serve on them, is under growing criticism. Calls are increasing for the boards to sever direct ties to banking and finance and become more diverse in their representation, as well as to offer more transparency to the public. As history shows, this governance model always has been the subject of political scrutiny, as public concepts of diversity — and the Fed's functions — have evolved over time.
3. Richmond Fed article on the Fed's capital structure and dividends to member banks. Helen Fessenden and Gary Richardson, "The Cost of Fed Membership," Federal Reserve Bank of Richmond *Economic Brief* No. 16-02, February 2016.
 - Abstract: Since the Federal Reserve's founding, it has paid a regular dividend to banks that are members of the Federal Reserve System in exchange for those banks holding stock in Federal Reserve Banks. Recent transportation legislation reduced these dividends and used the savings to help fund the bill. While this move provided a short-term financing fix, it also raised a much bigger question of whether banks will want to remain members of the Federal Reserve System.
4. Richmond Fed article on the 2015 highway bill. Helen Fessenden, "A Bridge Too Far?" Federal Reserve Bank of Richmond *Econ Focus*, Third Quarter 2015.
 - Summary: In a novel move, a new transportation-funding law is sending billions from the Fed's surplus account to help pay for roads, bridges, and mass transit.
5. Jeffrey M. Lacker statement on 2015 highway bill and Fed's capital structure. Jeffrey M. Lacker, "The Fed-Bank Relationship Under Scrutiny," Federal Reserve Bank of Richmond *Econ Focus*, Fourth Quarter 2015.
6. Jeffrey M. Lacker statement on the role of bankers on Reserve Bank boards of directors. Jeffrey M. Lacker, "The Importance of Bankers on the Richmond Fed's Board," Federal Reserve Bank of Richmond *Region Focus*, Second/Third Quarter 2012.

7. Richmond Fed article on the distributional effects of monetary policy. Renee Haltom, “Winners and Losers from Monetary Policy,” Federal Reserve Bank of Richmond *Region Focus*, Second/Third Quarter 2012.
 - o Summary: The Fed seeks to support the economy as a whole, but some redistributive effects are unavoidable
8. The Richmond Fed’s Perspective on Monetary Policy Independence. Our Perspective, Federal Reserve Bank of Richmond, May 2016.
 - o Summary: A Federal Reserve that is insulated from short-term political pressures but accountable to public concerns is more likely to pursue policies that align with its congressional mandate to promote stable prices, full employment, and moderate long-term interest rates.

“A Look Back at the History of the Federal Reserve”

August 29, 2013

Jeffrey M. Lacker
President
Federal Reserve Bank of Richmond

Christopher Newport University
Newport News, Virginia

The Federal Reserve, like many other central banks around the world, has been on the hot seat ever since the astonishing events of the financial crisis of 2008. Views about the Federal Reserve span a wide range, from those who would abolish the Federal Reserve outright and return to the pre-Fed monetary regime that tied the value of money to the value of gold, to those who applaud the institution for heroically preventing a repeat of the Great Depression. In between there are those who propose reforms to the legislation governing the Fed, and others who would leave the Federal Reserve Act alone but encourage the Fed to learn the right lessons from the crisis. Why the divergent views? Public debate has focused on the unprecedented interventions in financial markets and with failing financial firms and the unique operational independence the Fed enjoys relative to other government entities.

In our time together, I'll try to help you understand the current controversies surrounding the Fed.¹ To really understand these controversies, it helps to understand some of our unique characteristics as a central bank. And to do that, I'll argue that it's essential to go back to the founding of the Federal Reserve System in 1913 and learn why we were founded and why we were structured the way we were. It turns out that those who created the Federal Reserve 100 years ago wrestled with the same two critical questions that animate debate today: (1) our independence, that is, the structure of our governance and our accountability to the American people, and (2) what sort of assets the Federal Reserve Banks should invest in. These questions were hotly debated when the Fed was founded. I believe that the trade-offs and tensions involved are essential for an appreciation of the current debates and how central banking is likely to evolve as we enter our second century. Views on these questions differed then, just as views differ now. In that connection, I should caution that the views I will share with you are my own and do not represent the official views of the Federal Reserve System.

So let's cast our minds back 100 years to the signing of the Federal Reserve Act by President Woodrow Wilson on December 23, 1913. Why did the founders feel the need to create something like the Federal Reserve? The short answer they would have given is, “the currency problem,” by which they meant that the supply of currency did not expand and contract appropriately with the needs of the economy. This was evident during seasonal increases in the need for money, and during banking panics, when people wanted to withdraw their bank deposits

and hold currency instead. When people talked about the Fed's role in coping with financial panics, what they had in mind was expanding the currency supply.

Money and Banking Before the Fed

But to understand the currency problem, you have to know a little bit about how money and the banking system worked back then. It was different from what we're used to today. I should warn you that I'll be discussing some obscure workings of the banking system back then, but I think you'll see they're important to the story, so bear with me.

The most prominent feature of the U.S. banking system a hundred years ago was that it was incredibly fragmented. Laws prevented banks from operating branches, and as a result, there were a large number of individual banks. Banks generally had just one office, and essentially every little town had its own bank. There were nearly 30,000 banks in the United States in 1913. Laws limiting branching have gone away, and as a result, there are about 7,000 banks today.

What did people use for money? Coins, for one. They used gold coins, like this beautiful double eagle. But for small transactions, a gold coin of the right value would be impractically tiny. So large-value gold coins were supplemented by smaller-valued coins made out of silver or copper.

For very large transactions, however, coins were too bulky, and people preferred banknotes. Banknotes were paper currency issued by private banks. Here, I have to say a word or two about the National Bank Act, a law passed in 1863, during the Civil War.² It authorized the chartering of "national banks" by the federal government — up until that time, banks had been chartered by the states, who issued their own paper currency. The 1863 law authorized national banks to issue paper notes too, like the ones you see here, and a tax was levied on state bank notes that drove them out of circulation. National bank notes had to be backed by holdings of U.S. government bonds. This generated an immediate demand for government bonds, and so it helped finance the Civil War — or, more precisely, one side of the Civil War.

The process of issuing national banknotes was somewhat cumbersome. A national bank had to purchase the appropriate federal bonds; this was usually arranged through other banks in major financial centers. The bonds then had to be deposited with the U.S. Treasury, which then authorized the printing of notes by the Bureau of Engraving and Printing, using printing plates held by the Treasury. The notes were then shipped to the bank. The difficulty of this process plays an important role later in the story.³

Clearing and Settling Interregional Payments

The decades between the Civil War and the founding of the Fed saw rapid growth in interregional trade within the United States. Transportation networks were improving rapidly, and manufacturers were selling goods around the country. Making large payments at a distance posed special difficulties, however. Banknotes were poorly suited for the job because they were payable on demand to the bearer, and thus required insurance against theft when shipped. A convenient alternative was the check. If a check was lost or stolen, but someone presented it for

payment, the bank could refuse to pay, so checks are to some degree safer than banknotes. Checks became the payment instrument of choice in interregional trade.

To understand the founding of the Fed, it helps to grasp some of the details of how checks moved around the banking system back then.⁴ It will help to focus on a concrete example. So imagine a general store in Newport News in the 1890s that sells potbellied stoves made by a manufacturer in Brooklyn. The store owner writes a check drawn on his bank in Newport News, payable to the manufacturer, and mails it. The manufacturer deposits the check in his account at his Brooklyn bank. (Keep in mind that there wasn't an iPhone to scan the check into.)

Now what happens though? How does the Brooklyn bank get paid for the check drawn on the bank in Newport News? More generally, how did banks clear and settle checks? Two different institutional mechanisms developed to facilitate check clearing.

One was the clearinghouse.⁵ Any decent-sized city would have many individual banks, and they would band together in order to economize on the costs of presenting checks to each other for payment. Instead of each bank sending clerks directly to each of the other banks, they would send a pair of clerks to a central location. This engraving depicts the New York Clearinghouse some time in the 1850s. (This admittedly is earlier than 1913, but the operations basically looked the same, with the possible exception of the top hats and cutaways.) One clerk from each bank would move around the outside of the circle of desks, presenting bundles of checks in succession to clerks from the other banks. The clerk sitting behind the desk would tally the amount of checks presented by the other banks. After the presentation of checks was complete, clearinghouse clerks would collate and reconcile all the banks' tally sheets. At the end of the process, each bank has either a net obligation due to the clearinghouse, that is to the other banks, or else a net obligation due from the clearinghouse. They could either settle up that day, or carry over the balance to the next day.

Clearinghouses were an important feature of the banking system, both before the Fed and for many years after. In fact, as I'll discuss later on, the Federal Reserve Banks were modeled after the clearinghouses of the time, and several of their features were adopted for the Reserve Banks. First, banks that were members of the clearinghouse were often owed funds by the clearinghouse — that is, by other clearinghouse banks. As a result, member banks had a keen interest in each other's financial health. So clearinghouses set standards for membership, required periodic financial statements and regularly audited their member banks. In other words, clearinghouses performed functions very much like the supervision and regulation now performed by federal agencies, including the Federal Reserve. A second key feature of clearinghouses is that they were owned by their member banks. A board of directors, chosen by member banks, would set clearinghouse policies and rules and oversee the operations of the clearinghouse. Each Reserve Bank is overseen by its own board of directors.

Clearinghouses worked well in cities, where sending couriers to a central location every day was convenient. But outside the cities, banks were geographically dispersed. Here's where the second institutional mechanism used to clear checks comes in. It was called "correspondent banking."⁶ All the banks outside the cities — they were called "country banks" — established relationships with a number of other banks; these were called their "correspondents." If the country bank

received a check drawn on a distant bank, it would be sent to a correspondent to collect for them. Similarly, if the city correspondent bank received a check drawn on the country bank, they would send it to the country bank for payment. This slide shows a page from a publication that listed each bank and their correspondents. So if you were a bank in Brooklyn, and one of your customers deposited a check drawn on, say, the First National Bank of Newport News, you would just look them up in this book and find out who their correspondents were. The correspondents are listed at the bottom of their entry — I've outlined them in a red box. You could send it to the correspondent and get paid for it.

One critical feature of this system is that banks kept deposits with their correspondents. So the First National Bank of Newport News would have accounts with the banks listed at the bottom of its entry. These were called "reserve accounts" or just "reserves," and they played a critical role in the banking system. When checks came in to the city bank drawn on the correspondent country bank, the city bank would subtract (or debit) the amount from the country bank's account. Similarly, when the country bank sent checks for the city bank to collect for them, the city bank would add (or credit) the amount to its account.

If you multiply this picture across the nation, you end up with an intricate web of correspondent relationships linking very small country banks to larger banks in nearby cities to banks in the very largest financial centers — New York and Chicago. Through this network of relationships, people were able to make payments easily to people at great distances across the United States, analogous to the way electronic payment systems, like the credit card and ATM networks, link banks together in a way that enables payments to flow. The economics are very similar, it turns out.

The "Currency Problem"

I have given you an overview of the internal workings of the banking system in 1913, just before the Fed was founded. So what was the problem with this system that motivated the founding of the Fed? One word: inelasticity. At times, the supply of currency just did not expand rapidly and flexibly enough. Here's an illustration of that idea in a cartoon from 1909. Uncle Sam is pictured in the foreground, staring forlornly at a sheaf of wheat. His suspenders — they called them "galluses" then — are labeled "U.S. currency." His buttons are labeled "financial center." In the background, President Teddy Roosevelt explains the problem to a man labeled Congress:

"You see, those galluses ought to have rubber in them, so that when Uncle Sam stoops to move the sheaf there won't be much strain on the buttons."

To understand what they were talking about, think of the banking system as a whole; the public can hold bank deposits or banknotes. At times, people prefer more notes and fewer deposits than usual. One of those times was the fall harvest season, when more currency was needed to make the payments necessary to move crops to market; picture middlemen needing cash to pay farmers, who then use the cash to pay for supplies or repay loans. The holiday season in November and December was another time when the demand for currency rose; picture lots of people getting currency out of the bank to go shopping. But remember those cumbersome requirements associated with issuing new banknotes under the National Bank Act. That meant

the banks found it difficult to issue new notes. Country banks would turn to their correspondents for notes to meet the demand for withdrawals, which transmitted the strains to the big financial centers. The banking system had a hard time accommodating the increase in demand for currency. What was needed was a more elastic supply.

Those of you who have had an economics class are probably thinking, what about the price system? Isn't that how economies deal with scarcity? Well, the workings of the price system actually were evident back then. The price of money, as you economics students are aware, is the rate of interest — that's the opportunity cost of holding noninterest-earning currency, as opposed to holding interest-earning assets. Here is a plot (the blue line) of the average interest rate on commercial paper in New York (a good representative financial market interest rate in those days), shown for various months of the year in the 20 years before the founding of the Fed. You can see that from September through December, interest rates were substantially higher, about a full percentage point on average, compared to other months of the year. This is fairly direct evidence of the inelasticity that people were concerned about. After the founding of the Fed (the gold line), the curve is relatively flat, which is evidence that the Fed was able to better accommodate the seasonal swings in the demand for currency.⁷

The inelasticity problem was also evident during financial panics. These were episodes, generally during economic downturns, in which a sizeable number of people attempted to withdraw their money from banks. In other words, the public wanted to shift out of deposits into currency. These “bank runs” tended to happen in response to rumors of insolvency at one or more banks. Again, the cumbersome and time-consuming process for issuing new banknotes under the National Bank Act limited the response in the total supply of notes. Interest rates would spike up, as banks attempted to secure banknotes to meet the demand for withdrawals.

Banks turned to a number of expedients when faced with runs. One response when demand for notes was particularly acute was to “suspend payments,” meaning that banks would refuse to allow depositors to withdraw banknotes. At times, clearinghouses would declare suspensions for all their member banks. Often deposits weren't entirely frozen, however. Banks would issue “cashier checks” or other instruments that acted as substitutes for currency. These substitutes were viewed as inconvenient stop-gap measures, however.

Earlier I mentioned that country banks held deposits at correspondent banks. When their customers' withdrawals started rising, country banks would ask their correspondent banks for shipments of banknotes, to be paid for with their reserve account balances. During financial panics, clearinghouse banks would sometimes refuse those withdrawal requests in order to preserve cash for themselves.

The Panic of 1907 was the last straw; it sparked a concerted national effort to identify appropriate reforms to the currency system. Much debate ensued and numerous proposals were advanced, culminating in passage and signing of the Federal Reserve Act in December of 1913.⁸ What did the Federal Reserve Act do? According to the preamble of the Act, the intent was “to furnish an elastic currency.” That is, they wanted the aggregate supply of currency to be able to expand when the demand for currency rose, as it did during seasonal crop movements and the large-scale deposit withdrawals associated with banking panics. You'll also notice that the

preamble says “to afford a means of discounting commercial paper.” I’ll say more about that later.

The Federal Reserve Act

How would the Federal Reserve furnish an elastic currency? The natural model was the city clearinghouses.⁹ In banking crises, the clearinghouses often issued certificates to be circulated by their member banks as a substitute for currency withdrawals. (The clearinghouses were not legally entitled to issue bank notes themselves.) Therefore, the Act authorized the establishment of a set of banks modeled on the clearinghouses of the day. They called them “federal reserve banks,” because they would hold the reserves of the banking system, instead of having those reserves held in the banks in large cities. Reserve banks would have the power to issue notes, just as the national banks did at the time, except that the reserve banks would not be subject to the cumbersome requirements of the National Bank Act that made the supply of notes so inelastic.

Because the reserve banks were modeled after the clearinghouses, it was natural to provide them with the other features associated with clearinghouses. Thus the reserve banks were membership organizations, owned and operated by their member banks, much like a joint venture. They were given authority to examine their members for safety and soundness, just as the clearinghouses did.¹⁰ And they were given the power to clear and settle checks for their members as well, a core function of the clearinghouses.¹¹

Key Issue: Structure, Governance and Accountability

Perhaps the most visible aspect of the structure of the Federal Reserve was hotly debated: the number and location of the reserve banks themselves. One early version of the Federal Reserve Act would have created a single reserve bank with branches around the country. This riled populists, however, and tapped into the deep-rooted 19th century American aversion to large financial institutions and financial center interests. Carter Glass, the congressman from Lynchburg, Virginia, who chaired the House Committee on Currency and Banking and helped draft the final version of the legislation, insisted on a system of regional reserve banks.

President Woodrow Wilson, however, a leader of the progressive movement, insisted that because the reserve banks had a substantial public purpose, they should be supervised by a federal agency. So the Act established what is now called the Board of Governors of the Federal Reserve System to oversee the operations and policies of the reserve banks. The Board also has the power to appoint three of the nine members of each Reserve Bank’s board of directors — the other six are elected by member banks, and only three of them can be bankers. Members of the Board of Governors are appointed by the president of the United States and confirmed by the Senate. The Federal Reserve thus was created with a hybrid public-private governance structure. This structure has provided a measure of independence from political pressures that can induce an excessively short-run focus. That independence has been valuable, particularly in keeping inflation under control. But it comes with a responsibility to be accountable to our democratic institutions for the results of the conduct of policy.

The Fed's governance structure also was hotly debated during the drafting of the legislation. It has been questioned and amended over the years and remains controversial today. For example, critics have charged that the role of bankers on Reserve Banks' boards has biased them toward the interests of the banking industry, at the expense of the public interest. Others, however, cite the valuable operational expertise and economic information that bankers bring to the Fed. The financial reform legislation passed in 2010 in response to the financial crisis — the Dodd-Frank Act — imposed restrictions limiting the role of bankers in selecting the top officers of the Reserve Banks.¹² More broadly, the Federal Reserve has made significant moves toward greater transparency into its operations and decision-making over the last 20 years. This photo shows a gathering of all the Reserve Bank directors and the Board of Governors in October 1914, assembled on the steps of the Treasury in Washington. If the analogous group were assembled today, I can assure you of two things: You'd see greater diversity and fewer hats.

Key Issue: What Assets Should the Federal Reserve Hold?

Perhaps the most critical question the founders had to decide was what the Reserve Banks should hold as assets. The Federal Reserve notes that were authorized by the Act are liabilities of the Reserve Banks. The Reserve Banks also accepted deposits from member banks, another liability. The original goal of the founding of the Federal Reserve was to ensure that the quantity of the Fed's currency and reserve deposit liabilities would expand elastically when needed. This left the authors of the Act with some discretion as to what assets the Federal Reserve Banks would hold.

One asset that was natural to consider was gold, either in the form of coins or bullion. The country was on the gold standard at the time, and that required that banknotes be convertible into gold on demand. The founders decided to mimic the design of other central banks and require that Reserve Banks hold a certain amount of gold — 40 percent of the value of their notes outstanding, and 35 percent of the value of the bank deposits they accepted. This ensured that the Reserve Banks' money supply would tend to expand or contract with the movement of gold into and out of the country, as required by the rules of the gold standard.

But beyond gold, what assets should the reserve banks hold? One option was U.S. government bonds. The pre-Fed regime that required backing by government bonds was viewed as problematic, however, for the reasons I've already described. In addition, money backed only by government bonds was associated with inflationary wartime finance and thus viewed as potentially destabilizing. That left private-sector assets. There were active markets for private bonds, but these were relatively risky at the end of the 19th century, and stocks were even riskier. European central banks at the time, particularly the Bank of England, provided a natural alternative model, however. They held financial instruments called "bills of exchange"; similar instruments in the United States were called commercial paper. These were short-term (3- to 6-month maturity) obligations that arose out of the financing of trade. Because they were secured by goods in transit and endorsed by banks, they were relatively safe. Conservative eligibility requirements and an endorsement by the borrowing bank (a kind of guarantee) helped further reduce the risk to the central bank. So the Federal Reserve Banks were given the authority to make loans backed by certain types of commercial paper or purchase certain types of such commercial paper. This is reflected in the third part of the preamble purpose of the Federal Reserve Act: "to afford a means of rediscounting commercial paper." They called it

“rediscounting,” because the initial loan was essentially the purchase of an obligation at discount, which reflected an implied interest rate, and the Fed was discounting it a second time.

During World War I, the Reserve Banks were granted the power to hold Treasury securities, and thereafter they used purchases of Treasury securities in the open market to influence monetary conditions. Acquiring Treasury securities in the open market avoided the cumbersome collateral-posting procedure required under the national bank rules. It is important to note that the Fed creates money whether it buys Treasury securities, buys commercial paper or makes a loan. When a Reserve Bank acquires an asset, it credits the reserve account of the bank of the party from whom it acquires the asset. When a Reserve Bank makes a loan, it credits the reserve account of the party to whom it is making a loan. In either case, the new reserve account balances can be withdrawn by the bank, and Federal Reserve notes would be paid out, effectively converting the reserve balances into currency. In either case, the supply of currency plus reserves has increased. The key lesson here is that, for the purposes of the original goal of the Federal Reserve Act — that is, to solve the currency problem that the Fed was founded to solve and stem financial panics — it doesn’t matter whether the Fed lends or buys Treasury securities. Either one expands the supply of currency and reserves that people are clamoring for.

This highlights an important distinction regarding central bank activities. Some actions change the total amount of currency and bank reserves in circulation. These are best referred to as “monetary policy.” Actions that change the composition of the central bank’s asset portfolio, but leave the amount of currency and bank reserves unchanged can be thought of as “credit policy,” since they involve intervening in credit markets by buying one instrument and selling another.¹³ Credit policy has the potential to direct funds to particular sectors or particular private entities, either funds they would not otherwise have obtained or on terms they would not otherwise have obtained. The “currency problem” that the founders were seeking to solve was a monetary problem, not a credit problem.

This distinction is directly relevant to controversies about the Fed’s crisis lending programs, because they had little to do with monetary policy, in this sense, and thus little to do with the original goal of the Federal Reserve Act to furnish an elastic currency. Several emergency lending programs were introduced early in the crisis, prior to September 2008.¹⁴ Lending under these programs was all offset by sales of Treasury securities, so the supply of currency plus reserves did not increase. Instead, the lending programs reallocated credit, effectively selling Treasury securities to the public and using the proceeds to provide funds to private entities on terms they would not otherwise have obtained in the marketplace. Similarly, the loan made in connection with the failure of Bear Stearns in March 2008 was offset through sales of Treasury securities. Because the Reserve Banks remit all of their excess earnings to the U.S. Treasury, the fiscal implications for the federal budget were exactly as if the Treasury had issued new debt and made the loan.

Later, in the fall of 2008, the Fed drove short-term interest rates essentially to zero and stopped offsetting emergency lending. Clearly, though, the Fed could have driven interest rates to zero without the emergency lending programs by simply buying large quantities of Treasury securities. Since the crisis, the Fed has dramatically expanded the size of its asset holdings by acquiring longer-term Treasury securities and agency mortgage-backed securities, or MBS. The

Fed could have expanded its portfolio an equal amount through purchases of Treasury securities only. Compared to that benchmark policy, buying agency MBS channels funds to mortgage borrowers, financed through sales of Treasury securities to the public.

In popular accounts of the crisis, you may have come across references to the Fed as “the lender of last resort.” This phrase is often used to describe the prescriptions of Henry Thornton, the British economist, and Walter Bagehot, a British essayist and journalist. Both men wrote influential books on central banking: Thornton at the beginning of the 1800s, and Bagehot in the 1870s. Their recommendations to the Bank of England have been distilled into the phrase: “Lend freely at a high rate on good collateral.”¹⁵ This dictum is often invoked to support extensive central bank lending in episodes of financial distress. But Thornton and Bagehot wrote when lending was the primary mechanism by which the Bank of England increased the stock of money in circulation. Their writings make clear that they were not recommending rescues for insolvent institutions, and that their prescriptions were about monetary policy, not credit policy.

The Debate Continues: The Future of Central Banking

Some modern writers instead interpret the “lender of last resort” idea liberally to justify an expansive approach to central banking, in which all available tools, both monetary and credit policy, are used to minimize financial system “disruptions.” They read central bank charters as implying a “financial stability mandate.”¹⁶ Although the term “financial stability” was not at all common 100 years ago, they construe the founders of the Federal Reserve System as motivated by a broad desire to minimize and prevent financial panics, even beyond simply satisfying increased demands for Federal Reserve Bank money. The view that financial markets are inherently fragile and unstable provides support for this approach.¹⁷

In contrast, a narrow and more restrained view of central banking emphasizes the critical core function of managing the monetary liabilities of the central bank.¹⁸ Experience after the demise of the gold standard in the 1970s has demonstrated that a measure of independence is a critical ingredient in the success of monetary policy. Aggressive use of a central bank’s asset portfolio to channel credit to particular economic sectors or entities threatens dragging the central bank into distributional politics and places that governance arrangement at risk.¹⁹ This more limited approach is supported by the view that excessive financial market instability tends to be induced by government rescues, and that policymakers should be humble about their ability to identify constructive interventions in particular financial markets.²⁰

The evolution of the Federal Reserve, and central banking more generally around the world, will be driven, I suspect, by how the tension between these two approaches plays out. I just hope that future debates are informed by the rich deliberations that accompanied the founding of the Federal Reserve.

¹ I am grateful to Patricia Wescott for assistance in preparing these remarks.

² Milton Friedman and Anna Jacobson Schwartz, “A Monetary History of the United States: 1867–1960,” Princeton: Princeton University Press, 1963; Allen H. Meltzer, “A History of the Federal Reserve, Volume 1,” Chicago: University of Chicago Press, 2003; and Bruce Champ, “The National Banking System: A Brief History,” Federal Reserve Bank of Cleveland Working Paper 0723, December, 2007.

³ Bruce Champ, Neil Wallace, and Warren E. Weber, "Resolving the National Bank Note Puzzle," Federal Reserve Bank of Minneapolis Quarterly Review, Spring 1992, vol. 16, iss. 2, pp. 13-21.

⁴ See Jeffrey M. Lacker, Jeffrey D. Walker, and John A. Weinberg, "The Fed's Entry into Check Clearing Reconsidered," Federal Reserve Bank of Richmond *Economic Quarterly*, v. 85/2, Spring 1999, pp. 1-31.

⁵ James G. Cannon, "Clearing-Houses: Their History, Methods and Administration," London: Smith, Elder, & Co., 1900; and James G. Cannon, "Clearing Houses," National Monetary Commission, Government Printing Office: Washington, D.C., 1910.

⁶ See Spahr (1926).

⁷ Jeffrey A. Miron, "Financial Panics, the Seasonality of the Nominal Interest Rate, and the Founding of the Fed," American Economic Review, March 1986, vol. 76, no. 1, pp. 125-140.

⁸ On the creation of the Fed see Elmus Wicker, "The Great Debate on Banking Reform: Nelson Aldrich and the Origins of the Fed," Columbus, OH: Ohio State University Press, 2005; and Eugene White, "The Regulation and Reform of the American Banking System, 1900-1929," Princeton: Princeton University Press, 1983.

⁹ Charles Goodhart, "The Evolution of Central Banks," Cambridge, Ma.: MIT Press, 1988; Richard Timberlake, "The Central Banking Role of Clearinghouse Associations," Journal of Money, Credit and Banking, February 1984, vol. 16, pp. 1-15; Gary Gorton, "Clearinghouses and the Origin of Central Banking in the United States," Journal of Economic History, June 1985, vol. XLV, no. 2, pp. 277-283; and Gary Gorton and Donald Mullineaux, "The Joint Production of Confidence: Endogenous Regulation and Nineteenth Century Commercial-Bank Clearinghouses," Journal of Money, Credit and Banking, November 1987, vol. 19, pp. 457-468.

¹⁰ National banks were already supervised by the Comptroller of the Currency, as they are today, so the reserve banks were just given authority to supervise the state banks that joined the Federal Reserve System.

¹¹ See Lacker, Walker and Weinberg (1999).

¹² Specifically, section 1107 of the Dodd-Frank Act says that only Class B directors (nonbankers elected by member banks) and Class C directors (appointed by the Board of Governors) can elect the president and first vice president (chief operating officer) of the reserve bank.

¹³ This distinction is discussed at length by Marvin Goodfriend and Robert G. King, "Financial Deregulation, Monetary Policy, and Central Banking," Federal Reserve Bank of Richmond *Economic Review*, May/June 1988, vol. 74, no. 3, pp. 3-22.

¹⁴ These were the Term Auction Facility and the Primary Dealer Credit Facility. See <http://www.federalreserve.gov/monetarypolicy/bst.htm> for detailed information on the Board of Governors' website on all of the Fed's credit and liquidity programs. See <http://timeline.stlouisfed.org/> for a financial crisis timeline.

¹⁵ Henry Thornton, "An Enquiry Into the Nature and Effects of the Paper Credit of Great Britain," 1802, Edited and with an Introduction by F.A. Von Hayek, New York: Rinehart and Co., 1939. Walter Bagehot, "Lombard Street," London: Harry S. King and Co., 1873. For explanation and discussion of Thornton and Bagehot's views on the lender of last resort, see Thomas M. Humphrey, "Lender of Last Resort: The Concept in History," Federal Reserve Bank of Richmond *Economic Review*, March/April 1989, pp. 8-16; and Michael D. Bordo, "The Lender of Last Resort: Alternative Views and Historical Experience," Federal Reserve Bank of Richmond *Economic Review*, January/February 1990, pp. 18-29.

¹⁶ See Bank for International Settlements, "Central bank governance and financial stability," May 2011, <http://www.bis.org/publ/othp14.pdf> for an overview of financial stability mandates for central banks.

¹⁷ See Jeffrey M. Lacker, "Economics and the Federal Reserve After the Crisis." Speech at Franklin and Marshall College, Lancaster, PA, February 12, 2013, and "Understanding the Interventionist Impulse of the Modern Central Bank," Speech at Cato Institute 29th Annual Monetary Conference, Washington, D.C., November 16, 2011.

¹⁸ See Jeffrey M. Lacker, "Perspectives on Monetary and Credit Policy," Speech to the Shadow Open Market Committee Symposium, New York, NY, November 20, 2012.

¹⁹ Marvin Goodfriend, "The Elusive Promise of Independent Central Banking," Bank of Japan, Monetary and Economic Studies, November 2012, vol. 30, pp. 39-54.

²⁰ See Jeffrey M. Lacker, "Economics and the Federal Reserve After the Crisis." Speech at Franklin and Marshall College, Lancaster, PA, February 12, 2013.

Whom Do the Federal Reserve Bank Boards Serve?

By Helen Fessenden and Gary Richardson

The long-standing governance model of the Federal Reserve Banks, including their boards and the directors who serve on them, is under growing criticism. Calls are increasing for the boards to sever direct ties to banking and finance and become more diverse in their representation, as well as to offer more transparency to the public. As history shows, this governance model always has been the subject of political scrutiny, as public concepts of diversity — and the Fed's functions — have evolved over time.

The governance structure of the Federal Reserve System, including the leadership of the twelve Federal Reserve Banks, is increasingly drawing fire from a wide array of critics. Liberal groups have focused on Reserve Banks' boards of directors, which they believe are stacked too heavily in favor of private banking interests, too opaque, and insufficiently representative of women and minorities. The progressive coalition Fed Up, for example, calls for a ban on directors who have direct ties to banking and finance. It also has pushed for public nominations and public hearings for Reserve Bank presidents, who are currently selected by a subset of their Bank's nine-member board of directors (subject to approval by the Fed's Board of Governors). Coming on the heels of pressure from liberal members of Congress, the Democratic Party included language in its 2016 platform to prohibit executives of financial institutions from serving on Reserve Bank boards.

The leadership and board structure of the Reserve Banks also have conservative critics. Mark Calabria of the Cato Institute, for example,

recently wrote that the Fed, in general, has a "diversity problem" of too many economists from elite East Coast schools staffing the most senior levels, on the Board as well as at the Reserve Banks. "You are guaranteed to have an institution that suffers deeply from groupthink, as well as being insulated from the everyday experiences of most Americans," he wrote, suggesting reforms that included a ten-year residency requirement for candidates seeking to become Reserve Bank presidents.¹

By taking aim at the Fed, including its governance model, these disparate groups are finding common ground. Many of these critics fail to note, however, that the debate over the leadership structure of Reserve Banks is not new. The composition of Reserve Bank boards has been discussed and disputed throughout the last century. These arguments were especially intense in the run-up to the passage of the Federal Reserve Act in 1913, in the Great Depression, and during the civil rights movement and painful stagflation in the 1970s. The question has resurfaced most recently in the wake of the 2008 financial

crisis and the Great Recession, amid broader public scrutiny of the Fed. In fact, the debate over Fed governance, including Reserve Bank boards, is closely bound to the central tensions and grand compromises of American politics – encompassing the fights over local versus national government, progressive versus populist policies, and Wall Street versus Main Street economic interests. These arguments also reflect the tension between the desire for the benefits of a national bank and fears of financial monopolies and money trusts. The fact that these debates mirror such long-standing fissures in the American polity makes it all the more important to understand what the Reserve Bank boards actually do – and how these functions have evolved over time.

A Balancing Act

The German-American financier Paul Warburg, one of the key architects of the Federal Reserve Act, laid out a clear vision of how central bank boards should operate after the Panic of 1907 galvanized him to analyze America's fractured banking system. As he saw it, such a board should be "independent of politics" and not "swayed by selfish motives in its actions." At the same time, it had to be "thoroughly representative of the various interests and districts of the country . . . non-political, non-partisan, and non-sectional." And its members had to be equipped to deal with "broad questions of policy affecting the whole country" while being knowledgeable of local and regional economies.²

The authors of the Federal Reserve Act sought to achieve this diverse set of goals by dividing the nine directors of each of the twelve Reserve Banks into three classes, with each class representing different economic and public interests. Class A directors were bankers, elected by member banks to provide professional expertise and represent the interests of those institutions. Class B directors were also elected by member banks, but they did not work for or own stock in those banks; instead they represented commercial and community interests outside of banking and finance. Finally, Class C directors were chosen by the Federal Reserve Board in Washington, D.C., both for their expertise in running large, complex corporations and for representing the general public. Class

C directors could not serve as officers, directors, or employees of commercial banks while sitting on the board. However, under the framers' initial interpretation of the Act, two of them – those who served as the board's chair and vice chair – had to have "tested banking experience." In short, in the early years, five out of nine board directors had to have ties to banking or a substantial banking background.³ Under the modern interpretation of the Act, however, it is only one Class C director, the chair, who has to meet this requirement.

This structure made sense when the United States established the Federal Reserve. To set up this central banking system, Congress needed to convince bankers to provide expertise as well as funds. Federal and state governments did not spend a penny to establish the Fed. Instead, the Fed's founders convinced commercial banks to join the Federal Reserve System, and in doing so, invest tens of millions of dollars in the central bank, all paid in gold coin or bullion. The Fed used this gold to guarantee the value of the dollar, which at that time was on a gold standard.⁴

Using the model of a traditional corporate board, Congress envisioned directors as officials who would "perform the duties usually appertaining to the office of directors of banking associations and all such duties as prescribed by law," in the words of the Act. These duties covered tasks such as ensuring adequate staffing, establishing bylaws that employees should follow, and interpreting audit reports. As the Act's drafters saw it, then, it made sense to have professional bankers on Reserve Bank boards because they had the expertise to manage a bank. But just as importantly, Congress mandated that boards also have directors from outside the banking world to represent the public interest. This is one manner in which the Reserve Banks have a hybrid public-private governance structure.

Congress struck another careful compromise when it wrote the bill: it crafted the boards' composition to balance different regional and economic interests. To ensure regional representation, Congress directed that the nation be divided into Federal Reserve Districts and within each, a Reserve Bank be

established whose directors consisted of residents of that region. The Act mandated that the Class A and B directors hold jobs within their district, while the three Class C directors were required to have been residents of the district for at least two years. Congress also further split the Class A directors into three types to represent member banks by size, which ensured that large, medium, and small banks had equal representation. And to ensure balance of different commercial interests, Congress mandated that the Class B directors be “actively engaged in their district in commerce, agriculture, or some other industrial pursuit.”

Finally, a key goal of the Fed’s founders was establishing a central banking system that kept the value of the dollar stable. The Act’s authors understood that political pressures and private interests might push the value of the dollar down or up, and they feared both inflation and deflation. Accordingly, numerous features of the Federal Reserve System – such as its regional structure and the requirement to back Federal Reserve notes by either short-term bank loans or gold – were designed to insulate decisions about discount rates and the volume of notes in circulation from undue political and business pressures. Such checks against political influence were also incorporated into the Reserve Bank boards – for example, their prohibition of senators or representatives in Congress from serving as a director or officer of a Reserve Bank.

“Science” versus “Democracy”

The origins of the governance model go back to the Fed’s founding in 1913, when lawmakers were bitterly divided over the central bank’s purposes and functions. The political momentum for a central bank had accelerated after the Panic of 1907, but Congress struggled to resolve differences among those who wanted a regional, confederated structure and those who wanted a powerful central bank. Lawmakers from agricultural states pressed their interests, as did those who came from states active in mining and manufacturing. This was a debate about diversity, but one centered on addressing disparate state, commercial, and regional interests. More broadly, these early divisions reflected the fundamental schisms of that

era: “democratic” populism versus “technocratic” progressivism, urban versus rural interests, small versus big banks, and regionalism versus federalism.

How did this effort begin? Central banks were well-established in Europe, but among early American political leaders, the very idea of central banking was deeply controversial, as the demise of the First and Second Banks of the United States showed. This resistance began to change with a series of banking crises in the Gilded Age, capped by the Panic of 1907. Leading figures in finance began to work with like-minded lawmakers on creating a more stable banking system. In 1908, Congress passed the Aldrich-Vreeland Act, which established a National Monetary Commission to study other central banks and recommend a solution. The chairman of the commission, Sen. Nelson Aldrich, a Republican from Rhode Island, convened a small working group to draft the commission’s final recommendation, leading to a secret conclave on Georgia’s Jekyll Island in 1910 that included Warburg and Treasury official Abram Piatt Andrew. This effort led to the release in 1912 of the Aldrich Plan, the predecessor of the Federal Reserve Act.

The Aldrich Plan envisioned a National Reserve Association that had both “scientific” and “democratic” components. The “scientific” elements included technocratic proposals the Jekyll Island group saw as necessary for a central banking system to be effective, such as the authorities to provide an elastic currency and serve as a lender of last resort in panics. The “democratic” elements, meanwhile, were intended to address populist concerns that this new national bank would be an all-powerful, centralized entity. One way to do this was to distribute power across states, sectors, and regional interests by establishing local reserve associations. These local groups would in turn be organized into district associations. Each district would contain a branch of the National Reserve Association. Local associations would elect their own local boards of directors, which in turn would elect members of the district and national boards. In the local and district boards, bank-elected directors would make up the majority of the leadership, and voting rights

would be weighted in favor of larger banks. By contrast, the central body in Washington, D.C., was to be a relatively weak board made up of forty-six members, only six of whom the federal government would select. After its release, reception of the Aldrich Plan was mixed. Banking groups warmed to the plan, but many Democrats viewed it as tilted toward Wall Street. Meanwhile, the burgeoning Progressive movement was generally hostile to Aldrich and wanted a banking reform plan with far greater public accountability.

Early Compromises

As this debate raged on, the Democrats swept the 1912 election, sending Woodrow Wilson to the White House. Proponents of banking reform expected they would have to start from scratch, but in a surprise move, Wilson championed their cause. He delegated the drafting of the new bill, the Federal Reserve Act, to two Democratic allies, Rep. Carter Glass of Virginia and Sen. Robert Owen of Oklahoma. A finance professor, Henry Parker Willis, provided much of the technical expertise in the drafting of the House bill. Glass was among those Democrats who wanted a regional model with power spread out among as many as twenty Reserve Banks and no central coordinating board at all. Wilson, helped by Owen and more like-minded allies in the Senate, sought a central board and a greater federal role.

Ultimately, the Federal Reserve Act represented a collection of compromises that tried to bridge these divides. But on net, the “democratic” side won some substantive provisions. The bill called for a network of powerful Reserve Banks (ultimately numbering twelve, reduced from the twenty Glass had proposed) that were largely autonomous. They could set their own benchmark lending rates and select which banks to lend to, and they held their own gold stock. The director classifications were set up to ensure occupational “diversity” among directors, while all nine had a vote in appointing their Reserve Bank chief executive officer, then known as a governor, now called the president. Even though the central body in Washington, called the Federal Reserve Board, appointed the Class C directors, the bill required that they live in their Reserve Bank district.

The “scientific” camp secured some concessions as well. Wilson got his Federal Reserve Board, staffed by U.S. presidential appointees, with two executive branch officials, the Treasury secretary and the comptroller of the currency. But the Board’s main role was that of a loose oversight body, and it lacked the power to conduct credit or monetary policy on a national basis. In fact, the most dominant national official in the early years was the leader of the New York Fed, Benjamin Strong, also an important early backer of the Aldrich Plan.

This early arrangement reflected the widespread view that the Reserve Banks’ primary role was to ensure stable monetary conditions in their districts. The governors who led the Banks came from finance and business backgrounds, and the chief Bank functions were issuing cash and, later, clearing checks. The Reserve Banks also served as lenders of last resort through their discount windows, and they could decide which securities to buy or sell and at which price. In short, through their power in conducting open-market operations and setting a District-wide credit policy, the Reserve Banks had far more control than the central board over monetary policy, a subject that was little understood at the time. But in a speech at Harvard in 1922, Strong noted the importance of these authorities.

“There is ... one function of the Reserve System the importance of which cannot be over-emphasized,” he said. “It is, in fact, the heart of the System upon which the operation of every other part depends. I refer to the entirely new element which was superimposed upon our banking System in 1914 by the establishment of the Reserve Banks, which were given the power to influence or to regulate or to control the volume of credit. Every other function exercised by the Reserve Banks sinks into insignificance alongside of the far reaching importance of this major function.”

Strong also underscored the importance of the Fed’s public function – and its inherent relationship to the elected officials of the U.S. government. “The Federal Reserve System has always impressed me as being essentially a social institution,” he said. “It is

not a super-government, it is simply the creature of Congress, brought into being in response to a public demand. It was not created only to serve the banker, the manufacturer, nor the merchant, nor the Treasury of the United States. It was brought into being to serve them all.⁵

An Early Test for the Fed

The shortcomings of this system became apparent in the early years of the Depression. Faced with a wave of bank failures, the Reserve Banks were unable to unite around one common policy. Some officials believed in the “real bills” doctrine, which held that the Fed should act procyclically (that is, curtail lending and tighten liquidity during downturns). Others sought a countercyclical approach that boosted liquidity by cutting the discount rate and lending permissively. What this meant was that Reserve Banks took different responses in 1929–32 to extending credit, expanding the monetary base, and acting as lenders of last resort. This led to divergent economic outcomes across the nation. In a 2009 paper that compared bank failures in southern and northern Mississippi, a split-district state, researchers found a significantly lower rate of bank failures and a much milder recession in the southern half of the state, reflecting the Atlanta Fed’s aggressive actions as a lender of last resort. By contrast, the northern half, which was under the St. Louis Fed, saw much less aid to banks beset by runs and fared worse.⁶

The Fed’s inability to use its tools effectively and to pursue unified policy to counteract the Depression is now a well-known lesson. But this failure also produced the reforms that led to the structure of the far more centralized modern Fed. The most important was the 1935 Banking Act, which established the modern structure of the Federal Open Market Committee (FOMC), taking over the monetary-policy and credit-policy powers previously held by Reserve Banks. The Federal Reserve Board was renamed the Board of Governors of the Federal Reserve System, and it received enhanced powers to set bank reserve requirements, the discount rate, and interest rates for member-bank deposits.⁷ Furthermore, the Treasury secretary and the comptroller of the currency lost their seats on the Board, helping set up

a wall between the Fed and the executive branch that was cemented with the Fed-Treasury Accord of 1951. A more centralized and effective central bank emerged.

As for the Reserve Banks, they lost their exclusive authority to select their own chief executive officers, as the Board was given the power to veto appointments as well as renew them every five years. The Reserve Banks’ CEOs, the “governors,” were demoted and renamed “presidents.” While still an important position, this job now required collaboration over national monetary and credit policies with the Board of Governors in Washington – for example, by setting up a voting rotation for presidents on the FOMC and allowing them, voting or not, to participate in all policy meetings. Congress also slashed the pay of the Reserve Bank board chairmen. In short, after the challenges of the Great Depression, Congress altered the Fed’s governance model, moving away from the regional system established in 1913 to become a more centralized organization.

Checks and Balances

While the FOMC’s creation reduced Reserve Bank directors’ roles in crafting monetary and credit policy, they have continued to perform many of the functions that the Fed’s founders envisioned. One of their most important tasks is to select, supervise, and advise their Bank’s CEO, whose title, since the 1935 Banking Act, has been president. In the Fed’s early decades, the presidents were drawn mostly from banking, business, and sometimes law. Starting in the 1960s, however, Ph.D. economists began filling the ranks of presidents, as Reserve Banks built up their own research departments with trained academic economists to assist the presidents. In 1940, for example, nine of the twelve presidents were bankers and three were lawyers; none were economists. By 1980, eight of twelve were Ph.D. economists, a ratio that has largely continued to this day.⁸

Reserve Bank boards of directors also tend to select presidents who favor keeping the value of money stable, rather than risking inflation or deflation in hopes of attaining other policy goals. A 2014 study by Daniel Thornton and David Wheelock, both from

the St. Louis Fed, documented this pattern. They found that since the creation of the FOMC, bank presidents dissented from the committee's decision 180 times in favor of tighter (less inflationary) policy and thirty-five times in favor of looser (more inflationary) policies. Members of the Board of Governors, in contrast, dissented only sixty-nine times in favor of tighter policy and 125 times in favor of looser policy. Overall, presidents accounted for 72 percent of all dissents in favor of less inflationary policies, while governors accounted for 78 percent of all dissents in favor of more inflationary policies.⁹

Allan Meltzer's research on the causes of inflation in the 1970s helps to explain this difference between members of the Board of Governors and Reserve Bank presidents. In a 2005 essay, he argued that "politicians elected for four- or five-year terms put much more weight on employment – jobs, jobs, jobs – than on a future inflation." Politicians have tended to select members of the Board of Governors whom they think have beliefs aligned with their own. And politicians have sometimes pressured members of the Board of Governors to adopt policies aligned with their short-term interests. These pressures often have fallen directly on the chair of the Board of Governors. For example, in the 1960s and 1970s, Fed Chairmen William McChesney Martin Jr. and Arthur Burns were pressured to limit anti-inflation efforts by Presidents Lyndon Johnson and Richard Nixon, respectively. Burns, in particular, felt he had to acquiesce, at least to some extent, so that he could also remain an economic advisor to Nixon. By contrast, presidents of Reserve Banks may have felt less political pressure because they have reported directly to their boards of directors, composed of businessmen and community leaders who typically took a longer-term view of the economy's economic health than politicians running for reelection.¹⁰

The Modern Fed

Although many core features of the Reserve Bank governance structure date back to 1913, it has seen substantial changes as well. Some of those came in the 1970s, at a time when the Fed's reputation, more generally, was suffering during the Great Inflation. Amid concerns over conflicts of interest

at certain Banks, Congress conducted a probe in 1976 that included a review of Reserve Bank board minutes, which led to a set of proposed reforms. This push contributed to the 1977 Federal Reserve Reform Act, best known for establishing the dual mandate that the public is familiar with today. But it also expanded the scope of a federal conflicts-of-interest statute to include Reserve Bank employees, officers, and directors. This statute makes it a crime for a director, officer, or employee of a Federal Reserve Bank to participate in a matter in which, to his or her knowledge, he or she has a financial interest.¹¹

Moreover, Reserve Banks have had a long-standing practice, which the Board formalized as policy in 2011, of not providing directors with confidential supervisory information. Class A and Class B directors who are affiliated with thrift holding companies supervised by the Federal Reserve may not participate in matters such as approving the supervision and regulation department budget and the selection, appointment, or compensation of officers with responsibility for supervision and regulation.

The 1977 reform was significant in other ways. It amended the Federal Reserve Act's rules about the Reserve Banks' boards of directors, requiring that all directors be appointed "without discrimination on the basis of race, creed, color, sex, or national origin." And notably, it expanded the pool of potential directors on boards beyond the sectors outlined in the 1913 Act of agriculture, commerce, and industry. Under the new provision, the Class B and Class C directors were to be elected "with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers." A comparison of the entire population of directors from 1920 to today, in fact, shows that the percentage with formal banking affiliations has dropped from 52 percent to 36 percent, with a more diverse occupational mix – nonprofits, academia, medicine, and services – making up most of the difference. (See Figure 1 on the following page.) The academics include presidents, chancellors, and professors at major public and private universities. The nonprofit representatives include senior executives from the

United Way, Goodwill, and Habitat for Humanity.

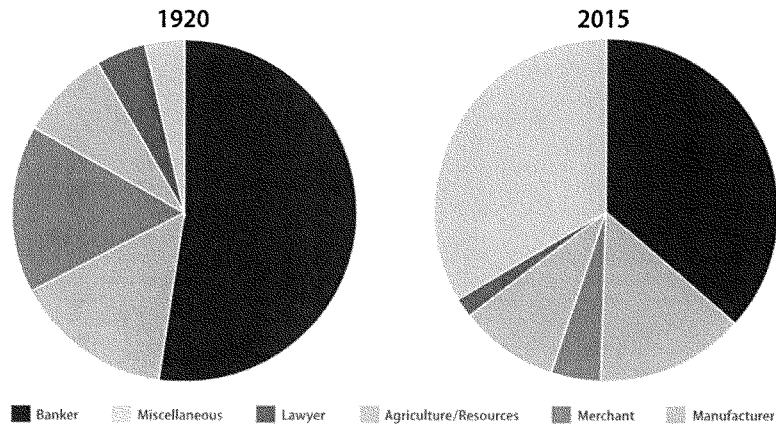
The Dodd-Frank Act of 2010 was the most recent reform of Fed governance, as part of a much more sweeping overhaul of financial regulation. One of its consequences was taking away the power of Class A directors (and certain Class B directors) to vote in the selection of Reserve Bank presidents on grounds that member banks should not have a direct say in selecting an official who influences when and how they can receive assistance from their lender of last resort. This measure addressed, in part, public anger at the New York Fed and its central role in bailing out Bear Stearns and American International Group in 2008. In the years preceding that crisis, then-President Tim Geithner recruited board directors from Lehman Brothers (Dick Fuld), JP MorganChase (Jamie Dimon), and Goldman Sachs (Steve Friedman). Fuld resigned just before Lehman collapsed in September 2008, while Friedman resigned from the New York Fed's board in 2009 after news broke that he bought Gold-

man Sachs stock during the crisis (technically while in compliance with Fed rules at the time).¹²

"The New York Fed president is often viewed as a servant of the financial establishment, in part because the optics of the institution's governance are awful," wrote Geithner in his memoir, *Stress Test*. "I made some changes to the board that unfortunately made those bad optics even worse."¹³

Since the Board of Governors enacted the changes in the Dodd-Frank Act, however, Class A directors (as well as Class B directors affiliated with thrift holding companies) may not participate in most aspects of the appointment process of Bank presidents and first vice presidents. This means they do not serve on the search committees for the president and first vice president or take part in the committees' deliberations about the candidates, nor do they vote for a president or first vice president, including voting for reappointment.

Figure 1: Composition of Reserve Bank Boards by Occupation



Sources: For 1920, sources include Reserve Bank annual reports, the U.S. Census of Population accessed via Ancestry.com, and newspapers from that time. Current data came from Reserve Bank websites and were categorized by the authors.

Notes: For 1920, the miscellaneous category includes two politicians, a newspaper editor, and a real estate executive. For 2015, the miscellaneous category includes three medical professionals, nine academics, two representatives of labor, nine leaders of non-profit organizations, three real estate executives, and nine leaders in the service industry.

Meanwhile, the Dodd-Frank reforms have coincided with changes that have been less visible to the public eye, including a jump in the representation of women and minorities on Reserve Bank boards. Since 2010, minority representation has increased from 16 percent to 24 percent among Reserve Bank boards, including branch boards, while the share of women has risen from 23 percent to 30 percent. (See Figure 2.) As for the Federal Reserve System more broadly, in 2015 staff at the executive senior level was 18 percent minority and 37 percent female.¹⁴ The Dodd-Frank reforms included a provision creating an Office of Minority and Women Inclusion across all banking agencies, as well as at each Reserve Bank. Moreover, the Fed has launched an interdisciplinary effort to focus on all initiatives that relate to diversity and financial inclusion, from hiring to community development to credit access, which Fed Chair Janet Yellen noted in congressional testimony in June.¹⁵

A common thread among Fed critics is that a reformed Fed, with a more diverse composition and a broader balance of interests among its boards, would act more boldly to help those who have struggled the most economically. This particular debate no doubt will continue as the Fed continues to weigh plans to tighten interest rates and unwind its balance sheet as the economy recovers. Many economists argue, however, that monetary policy alone is not

a sufficient or particularly well-designed tool to address inequality, which primarily stems from structural changes relating to globalization, technological change, demographics, and labor markets. As former Fed Chair Ben Bernanke wrote last year, the effects of monetary policy on inequality are “almost certainly modest and transient” in contrast to these long-term factors. For their part, he added, policymakers should look to “other types of policies to address distributional concerns directly, such as fiscal policy (taxes and government spending programs) and policies aimed at improving workers’ skills.”

“Policies designed to affect the distribution of wealth and income are, appropriately, the province of elected officials, not the Fed,” he added. “Alternatively, if fiscal policymakers took more of the responsibility for promoting economic recovery and job creation, monetary policy could be less aggressive.”¹⁶ ■

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Endnotes

- ¹ See Mark Calabria, “[Yes, the Federal Reserve Has a Diversity Problem](#),” Blog posting on Alt-M: Ideas for an Alternative Monetary Future, June 23, 2016.
- ² See Paul M. Warburg, *The Federal Reserve System: Its Origins and Growth*, Vol. 1, New York: Macmillan Company, 1930. The quotes cited here are on pages 22, 50, and 122, respectively.
- ³ See the *1914 Annual Report of the Federal Reserve Board*, pp. 7–8, which notes that “tested banking experience” should apply to the two “Federal Reserve agents” who were Class C directors.
- ⁴ The Federal Reserve required member banks to pay in their initial capital over time. Capital that was paid in exceeded \$54 million in May 1915 and remained over this level through the rest of the year. In December 1915, capital paid in stood at \$54,915,000. See *1915 Annual Report of the Federal Reserve Board*, p. 46.
- ⁵ See Benjamin Strong, “[Address Made before Students of Graduate College](#),” Harvard University, Cambridge, Mass., November 23, 1922.
- ⁶ See Gary Richardson and William Troost, “Monetary Intervention Mitigated Banking Panics during the Great Depression:

Figure 2: Rising Percentages of Women and Minorities on Reserve Bank Boards in Recent Years



Source: Board of Governors of the Federal Reserve System

Note: Minority refers to directors who described themselves to their Reserve Banks as African American, Native American, Asian, or Hispanic. By contrast, the 1920 composition of Reserve Bank boards was all male and all white.

Quasi-Experimental Evidence from a Federal Reserve District Border, 1929–1933,” *Journal of Political Economy*, December 2009, vol. 117, no. 6, pp. 1031–1073. A [working paper version](#) is available online.

⁷ Prior to the Banking Act of 1935, Reserve Banks had to receive approval from the Federal Reserve Board to change their discount rate, but the Board could not compel Reserve Banks to change their rate. The Board received that power from the Banking Act of 1935.

⁸ See Betty Joyce Nash, “[The Changing Face of Monetary Policy](#),” Federal Reserve Bank of Richmond *Region Focus*, Third Quarter 2010, vol. 14, no. 3, pp. 7–11.

⁹ See Daniel L. Thornton and David C. Wheelock, “[Making Sense of Dissents: A History of FOMC Dissents](#),” Federal Reserve Bank of St. Louis *Review*, Third Quarter 2014, vol. 96, no. 3, pp. 213–228.

¹⁰ See Allan H. Meltzer, “[Origins of the Great Inflation](#),” Federal Reserve Bank of St. Louis *Review*, March/April 2005, vol. 87, no. 2, part 2, pp. 145–175.

¹¹ See 18 U.S. Code § 208. This change in the 1977 Act specifically brought Fed employees, officers, and directors within the scope of the existing federal conflicts-of-interest statute, which had previously applied only to federal employees.

¹² The New York Fed applied for and received a waiver from the Board in January 2009 to allow Friedman (a Class C director) to stay on the Reserve Bank board after Goldman Sachs was converted to a bank holding company in fall 2008. Because he owned Goldman stock at the time and bought more shares during the crisis, Fed rules would otherwise have required him to step down. The waiver brought him into compliance, but Friedman stepped down from the New York Fed in spring 2009 anyway. Scott Alvarez, general counsel to the Fed Board of Governors, told the *Wall Street Journal* at the time that Friedman was needed during the New York Fed’s transition and that the conversion of Goldman into a bank holding company was “outside his control.” See Kate Kelly and Jon Hilsenrath, “New York Fed Chairman’s Ties to Goldman Raise Questions,” *Wall Street Journal*, May 4, 2009.

¹³ See Timothy F. Geithner, *Stress Test: Reflections on Financial Crises*, New York: Crown Publishers, 2014, pp. 88–89.

¹⁴ See Board of Governors of the Federal Reserve System, “[Report to the Congress on the Office of Minority and Women Inclusion](#),” March 2016, p. 4.

¹⁵ Hearing on the Semiannual Monetary Policy Report to the Congress, 114th Cong. (2016) (testimony of Janet Yellen, Chair of the Federal Reserve System Board of Governors).

¹⁶ See Ben S. Bernanke, “[Monetary Policy and Inequality](#),” Blog posting, Brookings Institution, June 1, 2015.

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Richmond • Baltimore • Charlotte

Statement of William E. Spriggs
“Diversity and Balance in Federal Reserve Leadership”
Testimony prepared for
The Subcommittee on Monetary Policy and Trade
Of
The House Financial Services Committee
114th Congress, Second Session
Hearing on
Federal Reserve Districts: Governance, Monetary Policy, and Economic Performance
September 7, 2016

Thank you to Chair Bill Huizenga and Ranking Member Gwen Moore for this invitation to give testimony before your subcommittee today on issues of governance, monetary policy and economic performance with respect to the regional banks of the Federal Reserve.

There has been much questioning of the conduct of monetary policy since the onset of the Great Recession and the financial sector collapse of 2007-2008. Economists continue to learn a lot about the causes of the collapse. Clearly, the role of exploitative mortgage instruments, and not the character of the borrowers, in the sub-prime market are a culprit.¹ President Obama responded to the need evinced by this to protect consumers, and the financial industry, by creating the Consumer Finance Protection Board in the Dodd-Frank Wall Street Reform and Consumer Protection Act legislation passed by Congress in July 2010. And, it reflects a sense that the financial regulatory agencies failed because they did not give consumer protection sufficient attention.

Economists have tried to understand what the Federal Reserve was thinking before the crisis, taking advantage of the transcripts of the meetings of the Federal Open Market Committee (FOMC), the monetary policy arm of the Federal Reserve Bank. Focus has been on the Fed’s

¹ Laurie Goodman and Wei Li, “New credit availability measure shows product risk, not borrower risk, fueled the housing crisis,” Urban Institute, 9 December 2014
<http://www.urban.org/urban-wire/new-credit-availability-measure-shows-product-risk-not-borrower-risk-fueled-housing-crisis>

recognition of the potential of the risks from a housing bubble.² Though equally disturbing was inattention to the potential harm to consumers. And, there has been focus on governance structure and concerns of regulatory capture, perhaps as benign as the use of common models producing “group think.”³

In my testimony, I will focus on the governance structure as it relates to economic performance measures. Let me first say that currently the Federal Reserve’s policies have been key in pulling the economy out of the worse downturn since the Great Depression, and a strong reason the United States is outperforming the rest of the advanced economies recovering from the Great Recession. But, the current structure does not guarantee this outcome. Sustaining the recovery without the typical accompaniment of fiscal policy is uncharted. So far, Chair Janet Yellen’s leadership has navigated this very well.

When the Federal Reserve system was created, interstate banking laws limited the reach of New York and Wall Street. Banks in the region still sometimes competed with state chartered banks. In Illinois, and some other states, there were even limits on branch banking. This tied the fortunes of banks in the various regions to the economies of their region. So, it might be argued that they could be sensitive to monetary policy that had different impacts on the industries in their region than on Wall Street banks. Today’s banking industry is very different. The level of concentration and the strength of a few national banks is much greater than in 1913. There is some evidence that Federal Reserve Regional Bank Presidents, are nonetheless, influenced by the unique unemployment rate experienced in their regions when they are members of the FOMC.⁴

There is a clear sense that the current governance structure, giving ownership of the regional banks to the banks within their jurisdiction reflects certain notions of interest capture. Most notably, regional bank presidents greatly reflect the gender and racial makeup of executives in

² Stephen Golub, Ayse Kaya and Michael Reay, “What were they thinking? The Federal Reserve in the run-up to the 2008 financial crisis,” *Review of International Political Economy*, 22, Issue 4 (2015): 657-692.

³ Lawrence G. Baxter, “‘Capture’ in Financial Regulation: Can We Channel it Toward the Common Good?,” *Cornell Journal of Law and Public Policy*, 21 (2011): 175-200.

⁴ Ellen Meade and D. Nathan Sheets, “Regional Influences on FOMC Voting Patterns,” *Journal of Money, Credit and Banking*, 37, No. 4 (2005): 661-677 while a different view is shown in Alexander Jung and Sophia Latsos, “Do Federal Reserve Bank Presidents Have a Regional Bias,” European Central Bank, Working Paper Series, No. 1731 (September, 2014)
<https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1731.pdf?6d19a02639b7e87fbb67ba31b62f91e5>

the banking industry. In its history, no regional bank president has been either a Latino or an African American. A recent review of the board members for the regional banks, who in turn recruit and nominate the regional bank presidents, showed that 83 percent were white and almost 75 percent were male. Again, a mirror of the executives in the banking industry. Only three of the board members represent labor organizations.⁵

At least one reserve bank president felt the absence of diversity when reflecting that the severity of the downturn's effect on unemployment in the African American community did not get mentioned in the 2010 FOMC transcripts; a year when the African American unemployment rate never fell below 15.2%.⁶ An odd oversight given the way in which subprime mortgage lenders targeted the African American community, and hence the collapse of home values, consumption and local government revenues would be correlated; giving insight where signs of deepening problems or signs of recovery might appear.

The other potential capture is that regional bank presidents and members of the Federal Reserve Board of Governors are overwhelmingly either academic economists or worked for Goldman Sachs. Economists in the academy are among the least racially or gender diverse of social scientists.⁷ And, only a small handful of schools produce the economists leading the Fed.⁸ This can allow for people who look like and communicate in a common language with the banking community. It does not mean capture, in thinking the same thing, but capture in agreeing on models, evidence and frameworks.

However, the process can, on occasion, produce regional bank presidents who are very responsive to meeting with the public. President Esther George, for instance, reaches out to meet with a diverse set of constituents including those most effected by high rates of unemployment. She has also opened up her annual research symposium to allow direct dialogue with those

⁵ Connie Raza, " 'To Represent the Public': The Federal Reserve's Continued Failure to Represent the American People," The Center for Popular Democracy (February 2016)

<https://populardemocracy.org/sites/default/files/Fed%20Up.pdf>

⁶ Narayana Kocherlakota, "MLK Day Reflections on the FOMC"

<https://sites.google.com/site/kocherlakota009/home/policy/thoughts-on-policy/1-18-16>

⁷ Amanda Bayer and Cecilia Rouse, "Diversity in the Economics Profession: A New Attack on an Old Problem,"

Princeton University Industrial Relations Section, Working Paper #597 (July 2016) <http://dataspace.princeton.edu/jspui/handle/88435/dsp01bc386m66h> and Gregory Price, "The Problem of the 21st Century: Economics Faculty and the color line," *The Journal of Socio-Economics*, 38, No. 2 (2009): 331-343.

⁸ Mark Calabria, "Yes, The Federal Reserve has a Diversity Problem," June 23, 2016 <http://www.alt-m.org/2016/06/23/yes-the-federal-reserve-has-a-diversity-problem/>

communities who have not fully recovered. Similarly, some of her fellow presidents, like President Jeff Lackner have followed suit to go outside the walls of the bank to meet directly with labor leaders in their region. But, regrettably, while some regional bank presidents have followed this lead, others have not. And, so while the system can produce presidents who seek dialogue with the public, it must be said that this level of outreach is new and it is not guaranteed. So, it is still too possible for regional presidents to be insular; moving in a closed circle.

Economists believe that the pre-amble to the Humphrey-Hawkins Full Employment Act, which reads:

“To translate into practical reality the right of all Americans who are able, willing, and seeking to work to full opportunity for useful paid employment at fair rates of compensation; to assert the responsibility of the Federal Government to use all practicable programs and policies to promote full employment, production, and real income, balanced growth, adequate productivity growth, proper attention to national priorities, and reasonable price stability;”

is a dual mandate that means the Federal Reserve should equally pursue full employment and maintain price stability. That is not what Congressman Hawkins believes was the intent. When he proposed the Act in 1977, the African American unemployment rate averaged 14.0% and reducing that was his focus.

A few years later, Paul Volcker as chair of the Federal Reserve Board of Governors took the maintenance of price stability as a mandate to engineer a massive and deliberate recession to lower inflationary expectations; unemployment spiked to levels not seen since the Great Depression, and for the entire 1980s, the African American unemployment rate would not fall below 11.0%. Economists call the subsequent period after economic recovery began in 1984 as the Great Moderation. It corresponds to a period that would be advantageous to Wall Street and reinforce the theories of some economists on the role of monetary policy.

Since 1984, inflation has averaged 2.7%⁹, and the variance in price movements was greatly reduced compared to before 1978. From 1948 to 1978, inflation averaged 3.6%, but with much wilder fluctuations.

In practical terms, from 1948 to 1978, when the Fed and fiscal policy makers were more sensitive to unemployment, the average monthly unemployment rate was 5.1%. During the Great Moderation it has averaged 6.1%. To understand the difference, since 1984, American workers have only spent 25% of the time with the monthly unemployment rate below the 5.1% average level of the pre-1978 era; this is despite a significant increase in educational attainment by all Americans, and a huge decrease in the variation in educational attainment.

It would be more accurate to say that the Fed pursues price stability, and tries to maximize employment consistent with that goal. That is not the same thing as pursuing full employment as the right of all Americans while maintaining reasonable price stability.

The Fed has one main policy tool, the ability to push short term interest rates up, or down. But, one tool with two policy objectives means the two goals must be weighted, since they potentially conflict. In 2007 and 2008, when the Fed was faced with a potentially destabilizing housing bubble, a third legislated mandate, the prudent management of the financial sector, added a third and very conflicting additional policy objective.

Getting the unemployment rate below 5.0% is critical to producing a labor market where workers can sustain wage gains, and labor market dynamics can let more productive workers quit lower paying jobs and move to more productive employment. This was one of the elements that helped hourly compensation for workers to increase along with productivity before 1974. For labor economists, that is a marker of the allocative efficiency of free labor market, and so is an indicator of full employment. However, since that period, a wedge has grown between compensation and productivity. And, the healthy churning of the labor market, with workers shifting to higher productive firms has been diminishing.¹⁰

⁹ Monthly CPI seasonally adjusted percent change from previous 12 months. The standard deviation was 3.12 from 1948 to 1978, and from January 1984 to August 2016 it is 1.35.

¹⁰ Steven Davis and John Haltiwanger, "Labor Market Fluidity and Economic Performance," National Bureau of Economic Research, NBER Working Paper No. 20479 (September 2014) <http://www.nber.org/papers/w20479>

Because of overt labor market discrimination prior to the passage of the Civil Rights Act in 1964, the forces of competition from full employment were greatly limited in lowering discrimination in the labor market. But, research has found that particularly for young workers who benefited from lower discriminatory barriers, between 1964 and 1980, there was convergence in labor market experiences for young African American and white men. The convergence was most marked for college graduates, where wage gaps were almost non-existent. But, beginning in the 1980s, and the prolonged period of extreme unemployment rates for African Americans in an economy with high unemployment, gaps in labor market outcomes grew; most noticeably for college educated workers who had such small gaps at the beginning of the decade.¹¹ When unemployment was allowed to fall near 4% in the late 1990s, research showed this helped start a reversal and gaps between young African American and white men started to shrink.¹²

Currently, the unemployment experience for better-educated African Americans is worse than the unemployment rates for less educated whites. This is true, even when controlling for cognitive test score differences.¹³ But, as the labor market tightens, there are fewer unemployed compared to the number of job openings, and those unemployment disparities grow smaller. And in fact, the work of competitive forces to lower discrimination is an explicit finding in the Humphrey-Hawkins Full Employment Act (Section 2 (b)(4)).

So, at full employment we would expect strong wage growth and lower levels of discrimination, consistent again with what labor economists would believe to be the allocative efficiencies of a free labor market. But, this definition of full employment, and the one of every able-bodied person finding a job at decent pay as described in the Humphrey-Hawkins Act are not the operating definition used by the Fed.

Again, with few tools but many goals, giving the proper weight to price stability and to unemployment means that policy makers must assign weights to the value of each goal.

¹¹ John Bound and Richard Freeman, "What Went Wrong? The Erosion of Relative Earnings and Employment Among Young Black Men in the 1980s," *The Quarterly Journal of Economics*, 107, No. 1 (1992): 201-232

¹² Richard Freeman and William Rodgers, III, "Area Economic Conditions and the Labor Market Outcomes of Young Men in the 1990s Expansion," National Bureau of Economic Research, NBER Working Paper No. 7073 (April 1999) <http://www.nber.org/papers/w7073>

¹³ Donna Rothstein, "An analysis of long-term unemployment," *Monthly Labor Review*, July 2016

That is why diversity in who serves on the FOMC is so important. Regional diversity is not sufficient to represent the different interests of the public in how the economy functions. Many institutional factors and history intervene such that the economy does not impact everyone the same. And, having different voices at the table is key in making policies that generally benefit the public.

So far, the Fed's structure has failed to provide that diversity. If the Fed had noticed in the latter half of 2007 that Latino and African American unemployment rates were rising, it might have understood a significant problem was on the horizon. Because the mortgage industry had targeted those communities with pernicious loan instruments with massive prepayment penalties, then the rise in unemployment would have been a warning that a large round of foreclosures was about to take place.

A similar challenge is present today. If the Latino or African American unemployment rates start to rise, the current pattern of sub-prime auto loans that have been targeted at those communities could mean that a rash of auto repossessions will occur, dumping a large number of automobiles on a market where auto sales have peaked. While that is unlikely to bring on the financial collapse of 2007, it could lead to a downturn in one of the shining sectors of this recovery.

As long as banks are owners of the regional bank system, and have an inordinate vote in selecting the board, it is hard to see how the regional bank system is likely to provide the diversity in leadership needed to have a wide range of interests at the table when the FOMC meets. And, again, this is not just bad for one community. The failure of the Fed in understanding the coming crisis of 2007 hurt the entire economy. Even regional bank presidents from areas where the sub-prime foreclosure crisis was most severe failed to see the sub-prime market problem as an issue—not to the complex financial relationships that ruined the economy, but to the real economy phenomena that has devastated the finances of local governments and wiped out the wealth holdings of a generation of African American households.

In fairness, the Fed was not alone. The global financial system collapsed. And, in other countries central bankers are selected and governed differently; some with a single mandate of price stability, others with no presence of banking industry on their boards. Generally, it

is agreed, the central bank of the United States did a far superior job of reacting to the crisis than did the European Central Bank or many other industrialized nations' systems. And, it is generally agreed that the sizable fiscal stimulus under President Obama in 2009 led to the current strength of the United States compared to the slower growth of the rest of the advanced economies.

The current consensus among economists, is that there is still a need for fiscal stimulus in the advanced economies. The International Monetary Fund, in making its recommendations for a healthier American economy, lists the need for increased investment in public infrastructure.¹⁴ Similarly, the Organization for Economic Cooperation and Development has noted that the advanced economies are stuck in a low growth equilibrium because of a failure to use low interest rates and current fiscal space to push their economies out of this trap. Failing to make the investments, in fact, will lead to higher debt-to-GDP ratios, because GDP growth is being retarded by austerity policies.¹⁵ Economists, from Nobel Laureates Christopher Sims, who addressed the Kansas City Federal Reserve Banks research symposium this past August, to Paul Krugman and Joseph Stiglitz all concur that what is needed at this point is a debt-financed fiscal policy to restore inflation to its target level and get employment levels to a normal level.

In fact, the fiscal response to this downturn is unique. In the 1980s and again at the start of this century, under President Reagan and President George W. Bush, Congress passed significant fiscal expansion that greatly increased the deficit to help push the economy out of recession. In doing that, Congress and the President were holding up their end of the requirements of the Humphrey-Hawkins Full Employment Act. The Act has clear requirements for fiscal authorities to report on what specific steps they plan to ensure full employment.

¹⁴ International Monetary Fund, *2016 Article IV Consultation with the United States of America: Concluding Statement of the IMF Mission* (June 22, 2016) <https://www.imf.org/en/News/Articles/2015/09/28/04/52/mcs062216>

¹⁵ Catherine Mann, "Policymakers: Act now to break out of the low-growth trap and deliver on our promises," (June 1, 2016) <https://oecdecoscope.wordpress.com/2016/06/01/policymakers-act-now-to-break-out-of-the-low-growth-trap-and-deliver-on-our-promises/>

So, though the Congress and President are elected by the public, there is no assurance that policies trying to achieve full employment will hold. But, public participation does allow for a diverse set of voices in the process. And, so while Congress has failed to pass a fiscal stimulus since 2009, it is clear that some members of Congress and that the President in his budget has pushed many times to provide the same type of fiscal response seen in 1981 and 2001.

But, going forward, with the Fed, it is not guaranteed that many voices will be at the table. And, as the world grows more complex, the outcome of short term interest rate movements can have many consequences. Other central banks with responsibilities for balance of payments and currency react to the Fed policy choices that may affect the value of the dollar, or the demand for commodities or the price of corn. And, those central bank actions can affect the real wages of workers in their country, and the relative wages of Americans to those workers. Will all the voices of the public who may be effected by Fed policy get their say? And, would a broader set of interests and viewpoints enrich the Fed decision making process to avert harm in the real economy?

I believe that a narrow focus on price stability, with the intent of keeping inflation within a narrow range, has its value, but needs to be considered with a host of other factors which can have varying risks associated with them. A bank-controlled system is unlikely to look at the world from a borrower's perspective enough to properly assess those risks. I also believe that it is not possible to assess the role of the Fed in economic policy in isolation, since the Humphrey-Hawkins Act, and economists would generally agree, that the role of fiscal authorities is as important.

I think there is room for serious discussion of whether the current structure of bank ownership of the regional banks gets in the way of the FOMC having the necessary diversity to make well informed decisions that can weigh all the various interests in the American economy. While the current leadership of the Fed under Chair Janet Yellen is amenable to increasing that diversity, I think her efforts could be aided by a change in structure; and the American public would benefit in the future if diversity was assured by the structural design.

